



The State of the Economy and Prospects for Tax Revenue in Tennessee

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by

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The State of the Economy and Prospects for Tax Revenue in Tennessee

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The U.S. Economy in Perspective

Speed Bumps: Bank Capital Crumble—Déjà Vu All Over Again

Estimates of dimension of subprime mortgages differ a bit but are uniformly large differ

- One puts subprime at \$1.2 trillion of the \$10 trillion outstanding mortgage market
- Another puts it a bit higher at less than 15% of \$11.5 trillion mortgage market

Problem would persist for some time

- One estimate sees 100,000 subprime resets per month for next two years
- FDIC puts the resets at 1.54 million by the end of 2008

Deutsche Bank analysts (11/12) estimate global loss at \$300-\$400 billion

- If so, banks would be forced to write down \$60-\$70 billion, including \$25 billion to date

Royal Bank of Scotland puts global losses at \$250-\$500 billion

Another sees capital wiped out if institutions must use **Level 3** rules

New FASB asset quality definitions

Level 1 – mark-to-market; asset's value is based on a real price

Level 2 – mark-to-market, value based on observable inputs used when no quoted prices are available

Level 3 – value based on unobservable inputs reflecting companies' own assumptions about the way assets would be priced

Estimates of **Level 3** assets as percent of capital

- Merrill Lynch & Co. – 38%
- Morgan Stanley – 251 %
- Goldman Sachs Group Inc. – 85 %

Level 3 assets must be marked to market



The U.S. Economy in Perspective

Speed Bumps: Capital Crumble and the GSEs

FNMA and FHLM own or guarantee 40 percent of the \$11.5 trillion U.S. home loan market

FHLMC (Freddie Mac)

- Reported a net loss of \$2.02 billion in 3Q2007
 - Due partly to setting aside \$1.2 billion for credit losses and writing down the value of assets by \$3.6 billion
- Capital is \$34.6 billion, only \$0.6 billion above the mandatory level set by the Office of Federal Housing Enterprise Oversight (OFHEO).
- Needs more capital
- Ability to support housing severely crimped

FHLMC – continued

- Risks remain – holds \$105 million in securities backed by subprime mortgages of \$713.1 billion

FNMA (Fannie Mae)

- Third-quarter net loss put at \$1.39 billion
- Due to
 - \$2.24 billion decline in the value of derivative contracts
 - \$1.2 billion in credit losses among the \$2.7 trillion of mortgage assets Fannie Mae owns or guarantees
- Ability to support housing crimped



The U.S. Economy in Perspective

Speed Bump: Stress Building in Corporate Sector

Size

U.S. corporate bond market totaled
\$3.8 trillion (outstanding par value)

- 83% investment grade
- 17% speculative grade

Separately, industrial bonds,

- Speculative grade is 30%
- Investment grade is 70%

Downgrades on the rise

Most rating changes in the third quarter involved investment-grade bonds rather than speculative-grade issues

- Earlier this year, downgrades concentrated in noninvestment grade

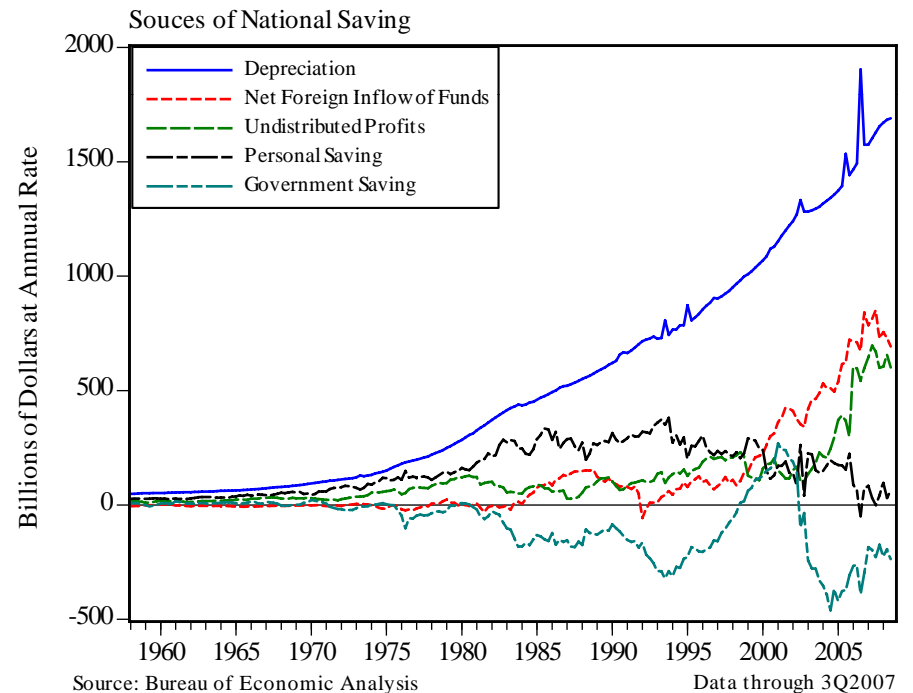
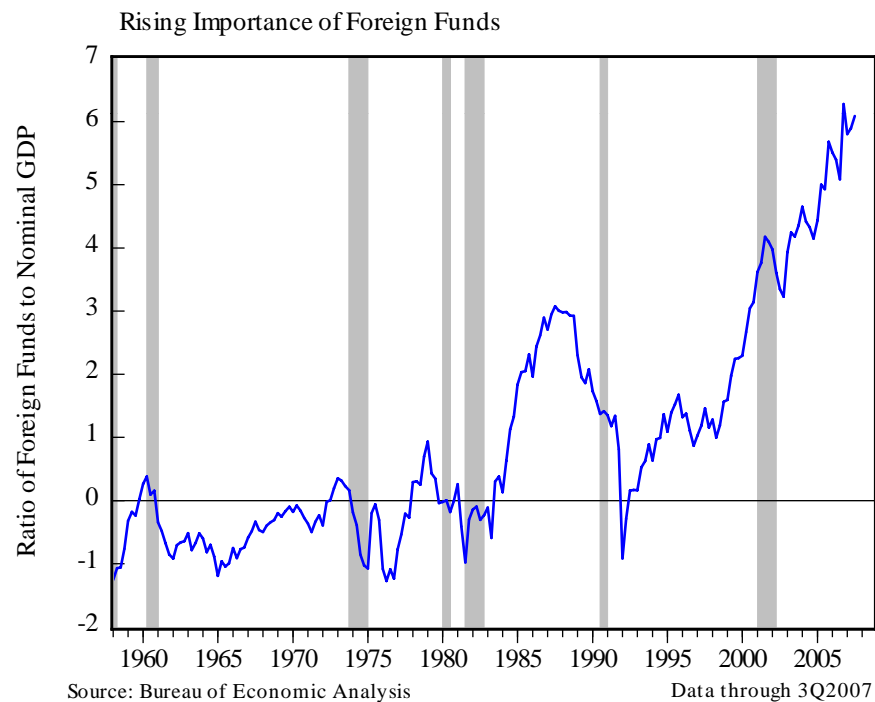
Downgrades reached 3.0% of investment-grade volume in the third quarter and upgrades 1.2%.

Defaults

Defaults estimated to rise from 1% to 4% next year

The U.S. Economy in Perspective

Speed Bumps: U.S. Capital Inflows and National Savings





The U.S. Economy in Perspective

Speed Bumps: International Factors and the Dollar

Sovereign Wealth Management Funds

- Represents actively managed portion of a country's foreign reserves
- Recent efforts to diversify exchange exposure has had an impact on the dollar
- Governance—issue of role of significant ownership of U.S. (and European) corporation by foreign central banks

End of Dollar Peg

Hong Kong \$ may go to a float or be replaced by the yuan

Several gulf states have (Kuwait) or may drop their dollar pegs (UAE, Qatar)

Diversification

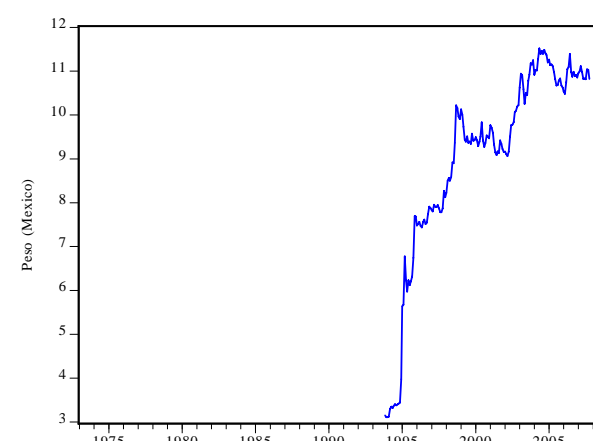
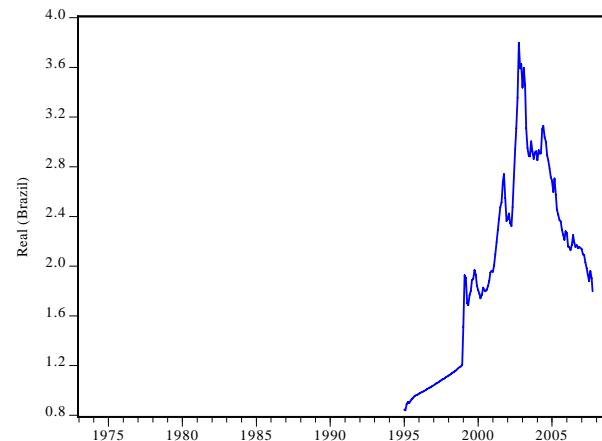
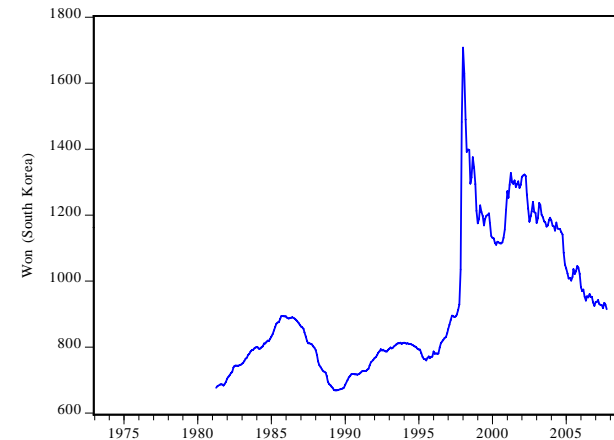
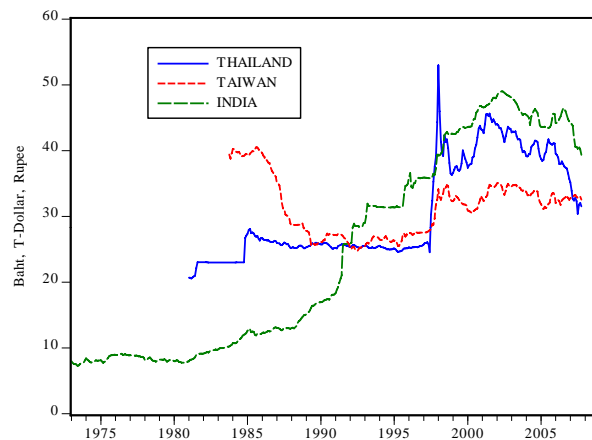
Japan, China, and Taiwan sold U.S. Treasuries at the fastest pace in at least five years in August

- Japan cut its holdings by 4 percent to \$586 billion, the most since a new benchmark for the data was created in March 2000,
- China's ownership of U.S. government bonds fell by 2.2 percent to \$400 billion, the fastest pace since April 2002
- Taiwan's slid 8.9 percent to \$52 billion, the most since October 2000

As dollar depreciates, it becomes less attractive as investment vehicle

The U.S. Economy in Perspective

Speed Bumps: Dollar versus Emerging Market Currencies



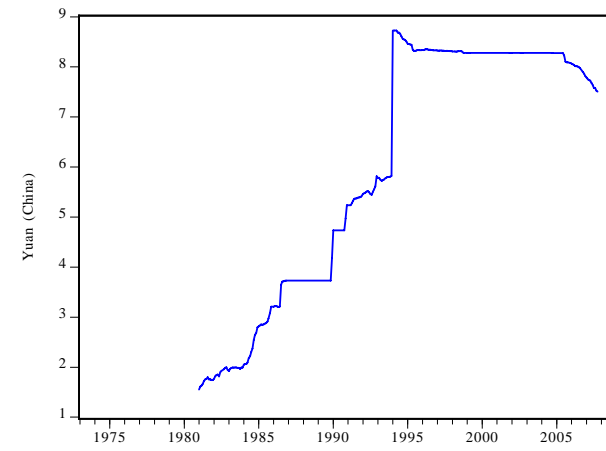
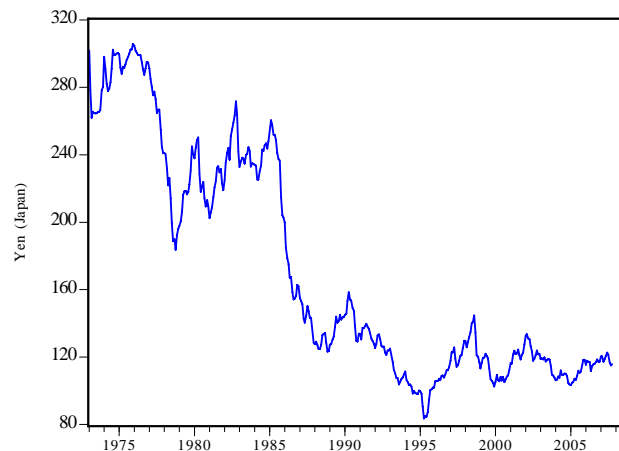
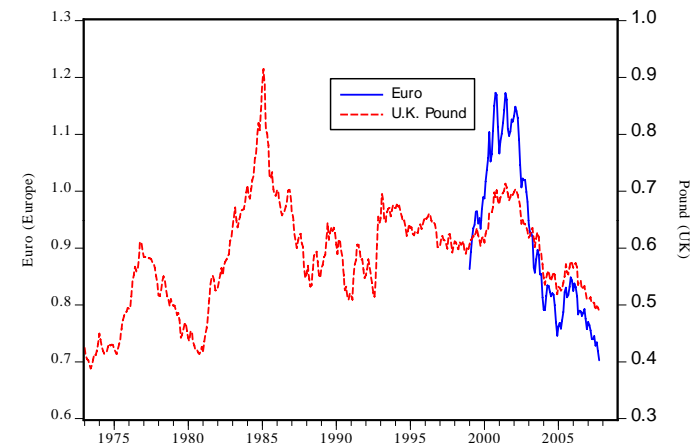
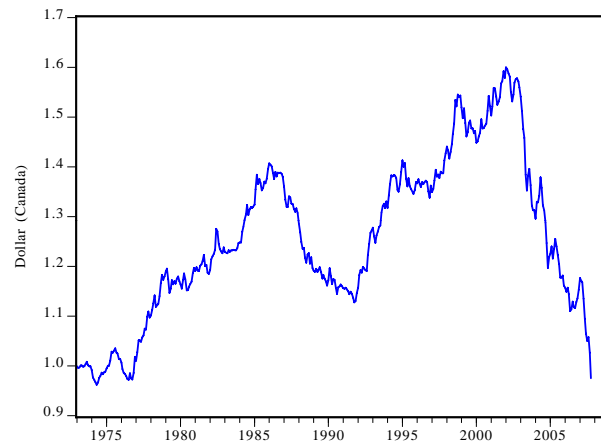
Data through November 2007

Data express as foreign currency per dollar

Source: Federal Reserve

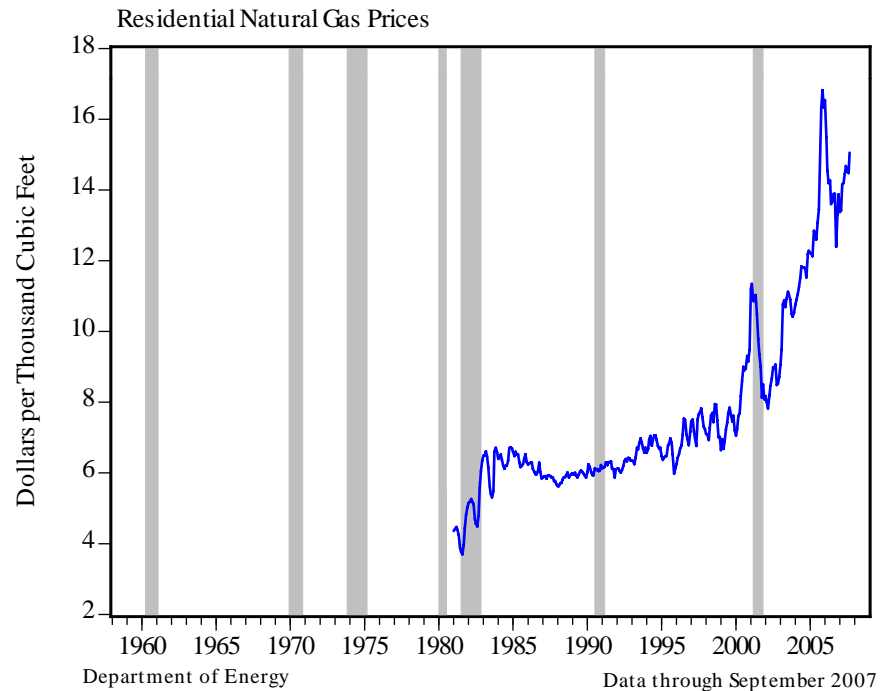
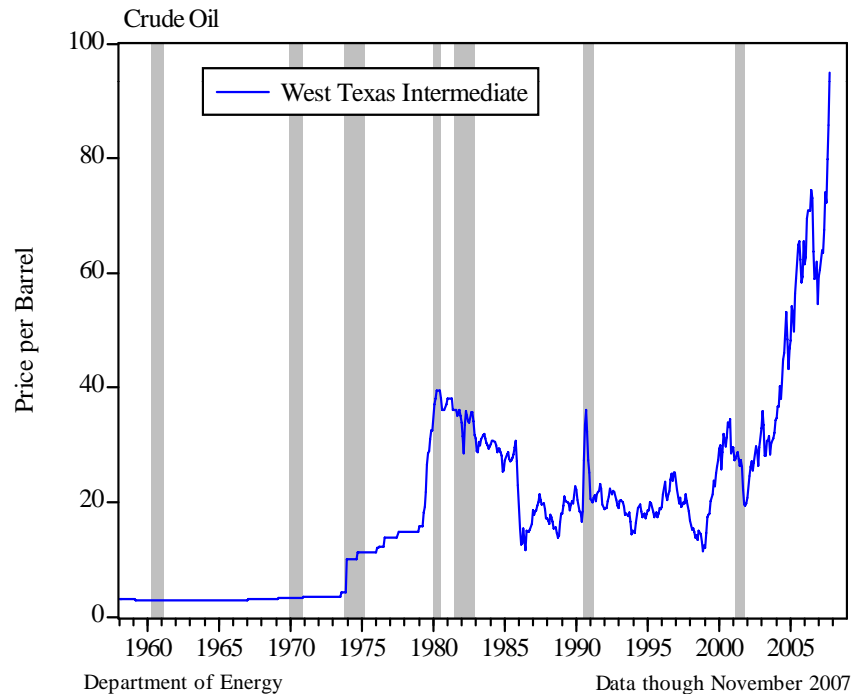
The U.S. Economy in Perspective

Speed Bumps: \$ Versus Industrialized Countries



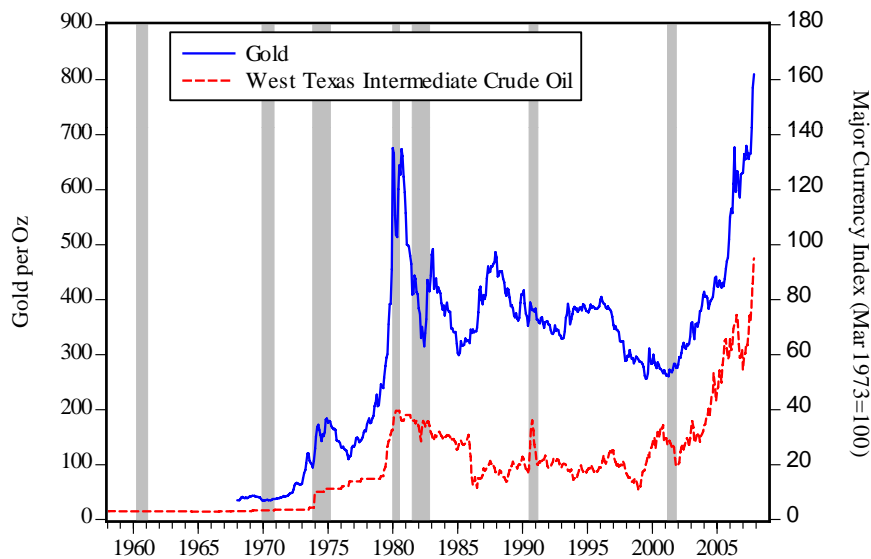
The U.S. Economy in Perspective

Speed Bumps: Oil and Natural Gas Prices

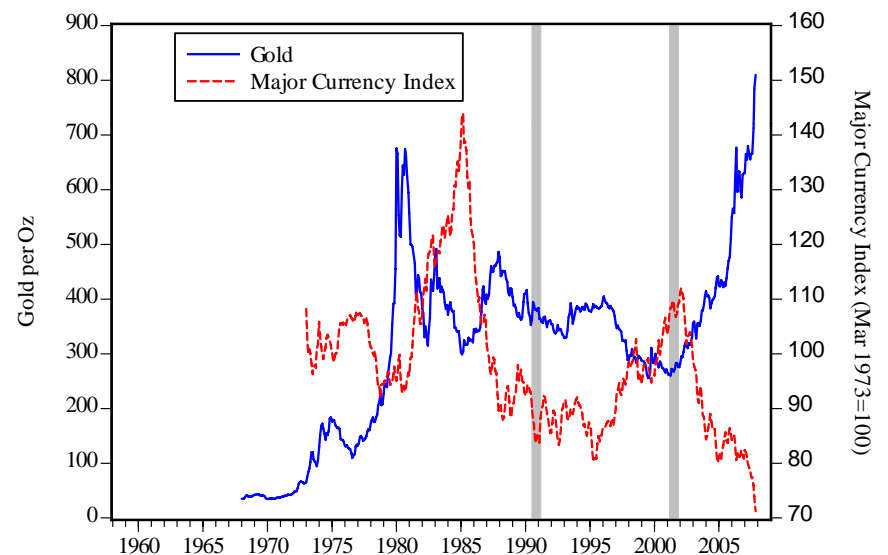


The U.S. Economy in Perspective

Speed Bumps: Gold, Oil and the Dollar



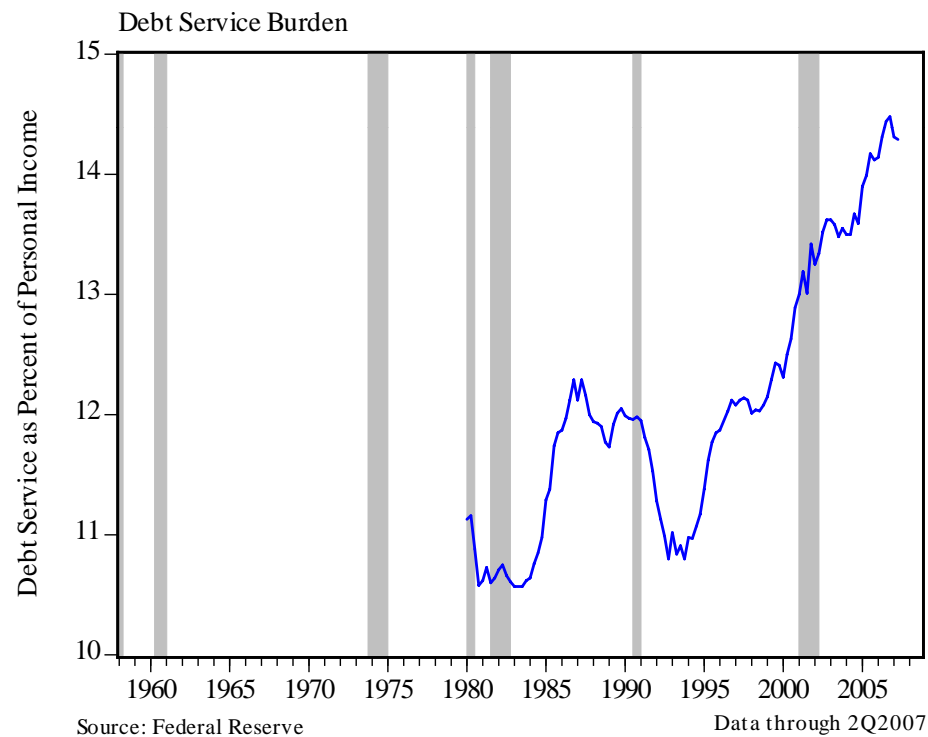
Source: Department of Energy (Oil) and Federal Reserve (dollar) Data through November 2007



Source: London PM Fix (gold) and Federal Reserve (dollar) Data through November 2007

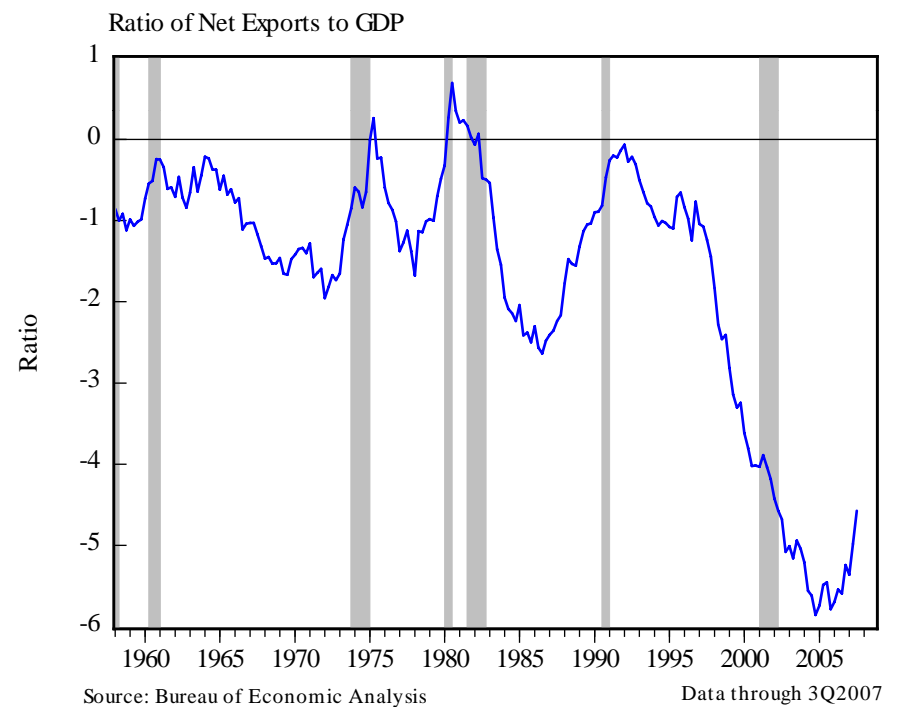
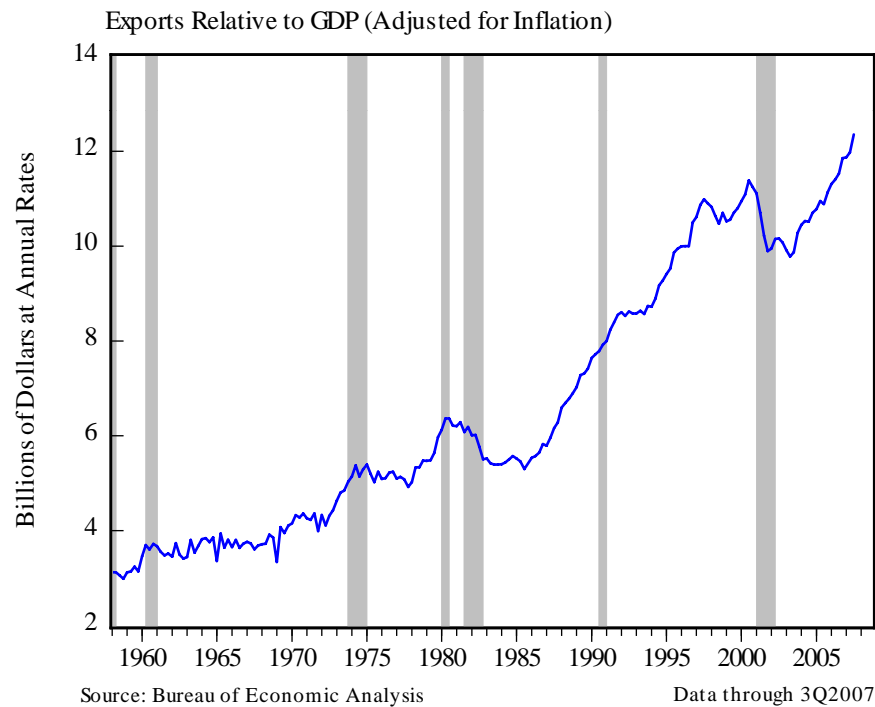
The U.S. Economy in Perspective

Speed Bumps: Household Debt Service Burden



The U.S. Business Cycle in Perspective

The U.S. in the Global Economy



The U.S. Business Cycle in Perspective

Recovery in Technology Spending Still Dominates the Investment Spending Picture

Business equipment and software

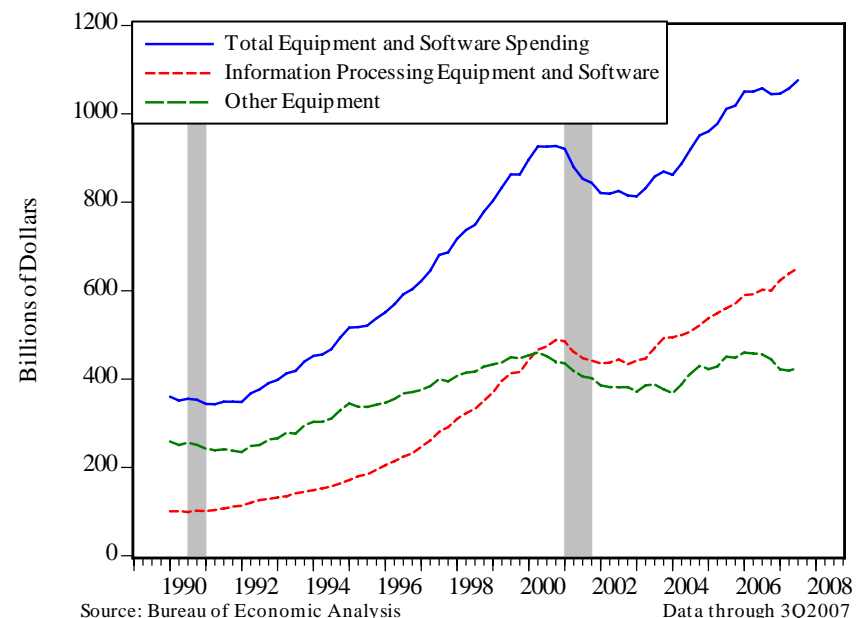
- So far this year 60 percent of total is devoted to information-processing equipment
- Remainder is spread among industrial, transportation, and other equipment

Upturn in technology spending led the upturn in general investment spending throughout this expansion

The strong technology spending in recent years is likely behind the productivity gains in the current economic expansion

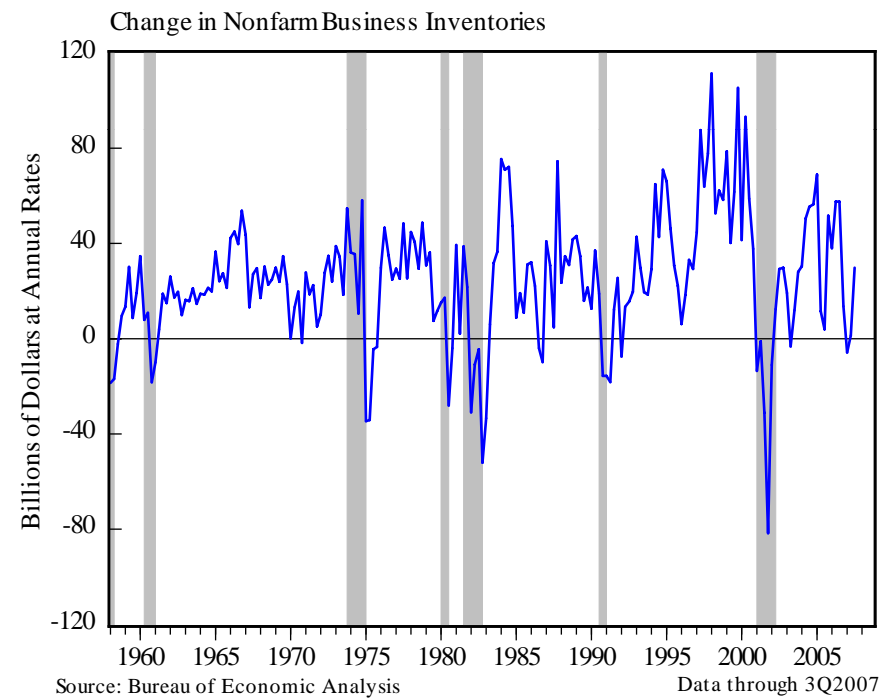
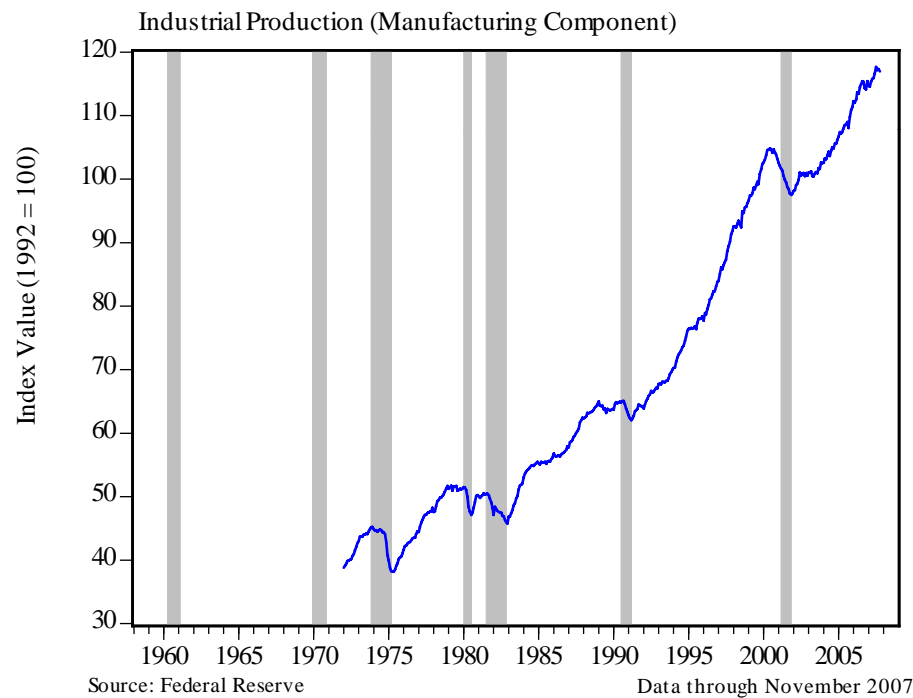
But spending on general investment goods has barely reached its last cyclical peak

This reflects ample capacity in the manufacturing sector (roughly 81 percent in August 2006)



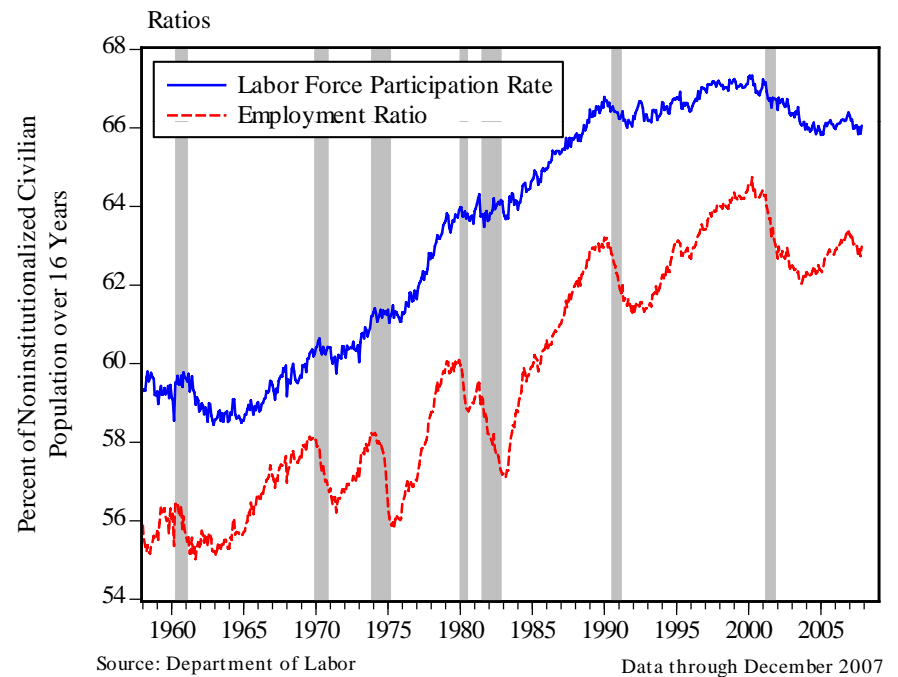
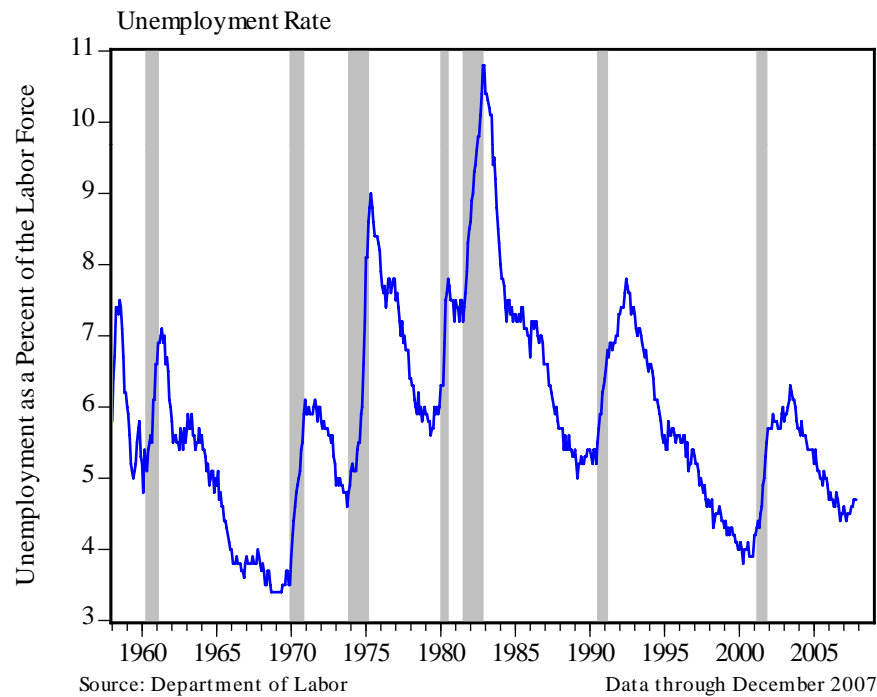
The U.S. Business Cycle in Perspective

Industrial Output and Changes in Inventories



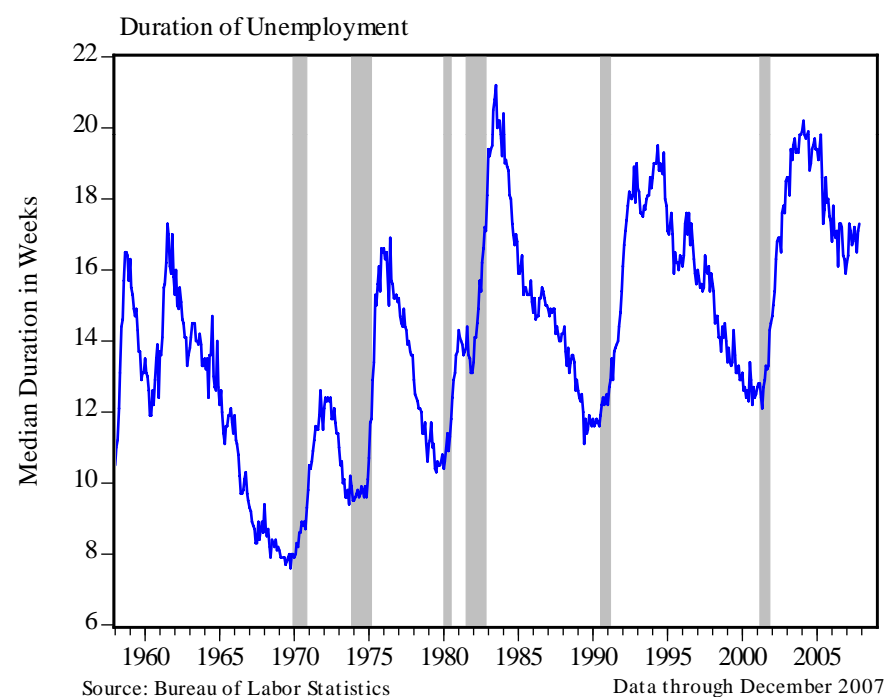
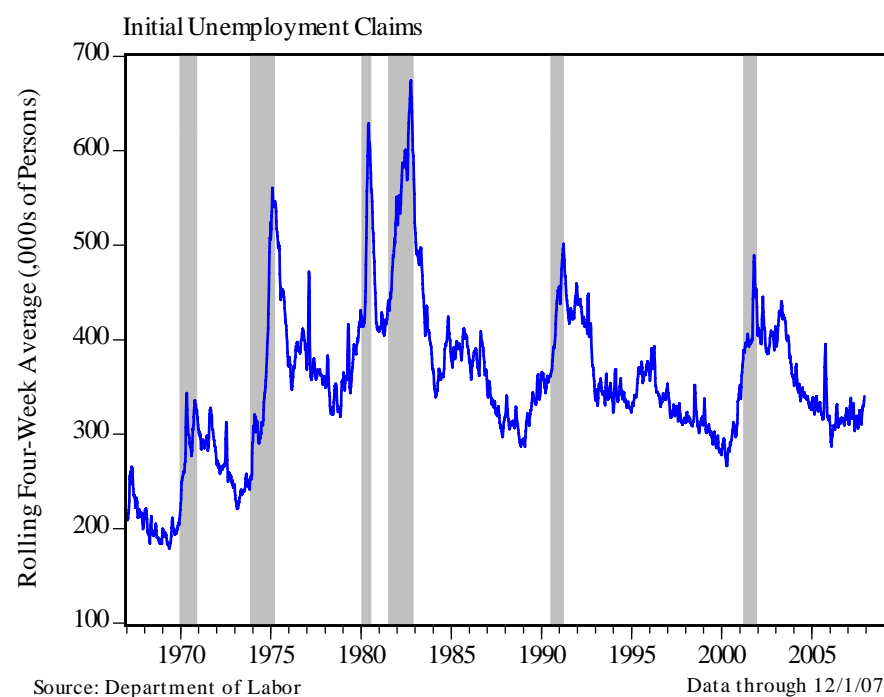
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Labor Markets: Unemployment, the Labor Force Participation Rate and Employment Rate



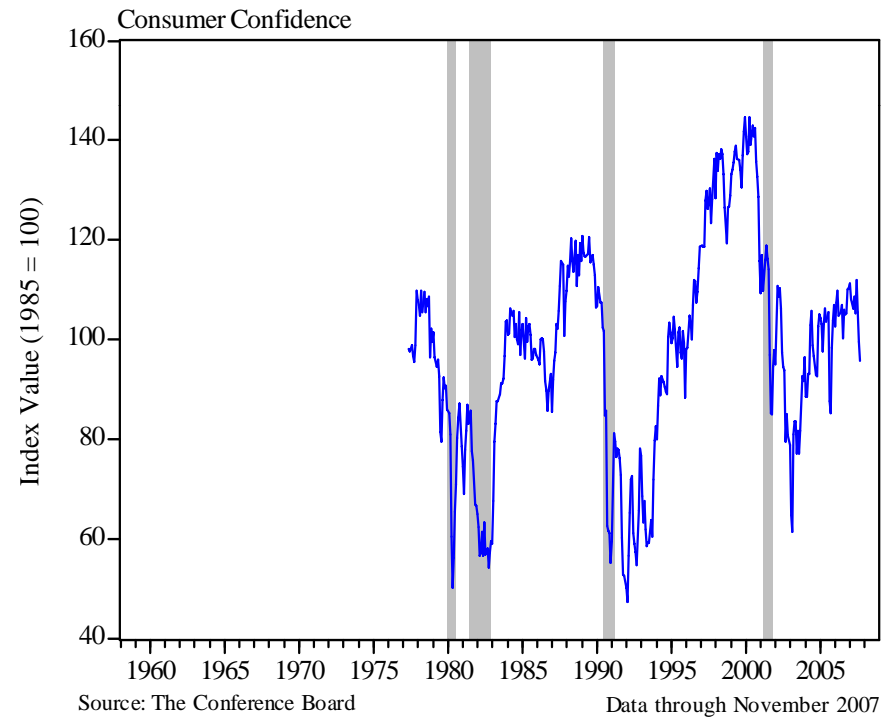
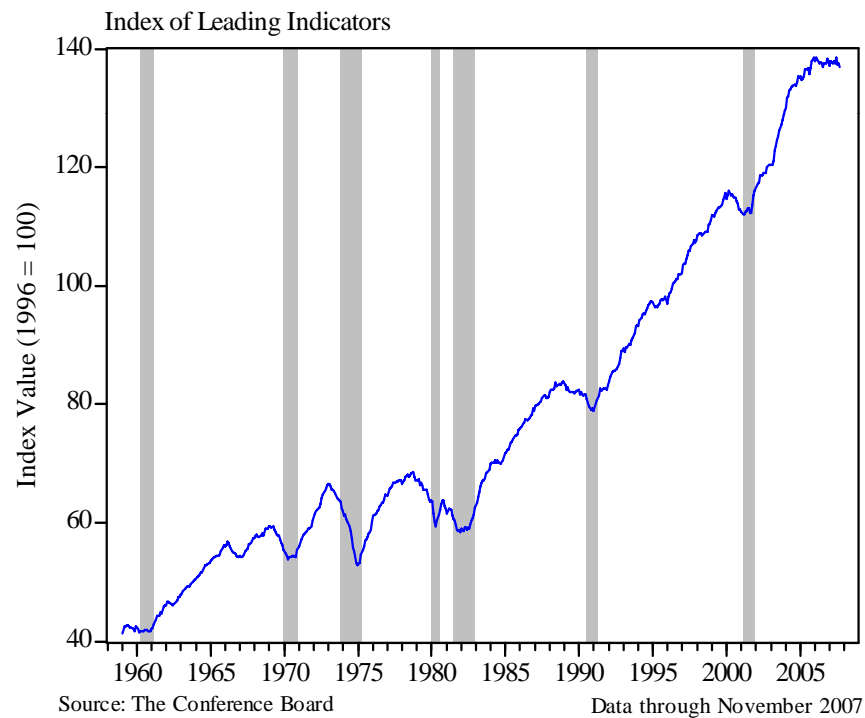
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Labor Markets: Initial Unemployment Claims and the Duration of Unemployment



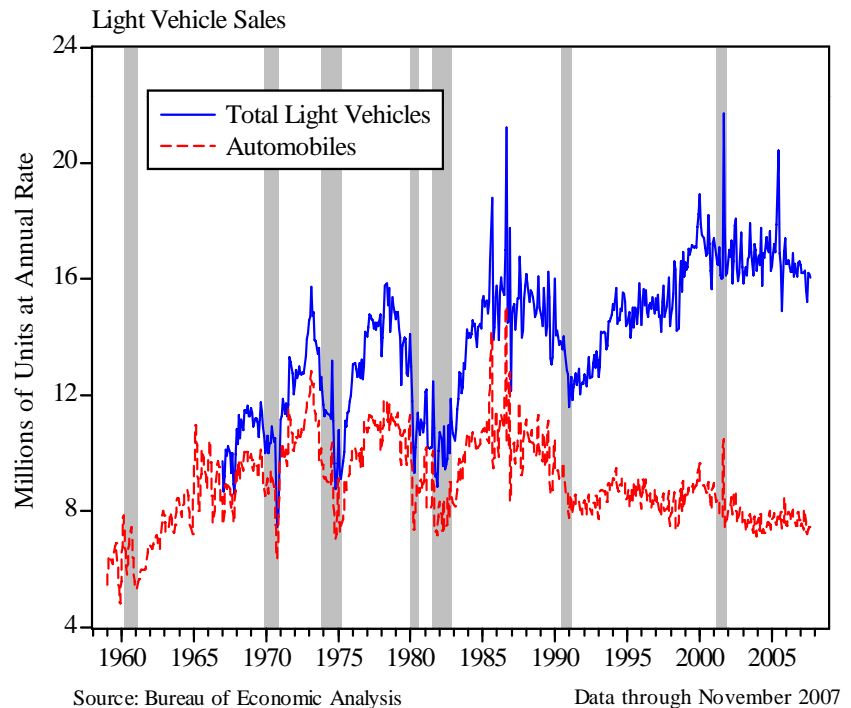
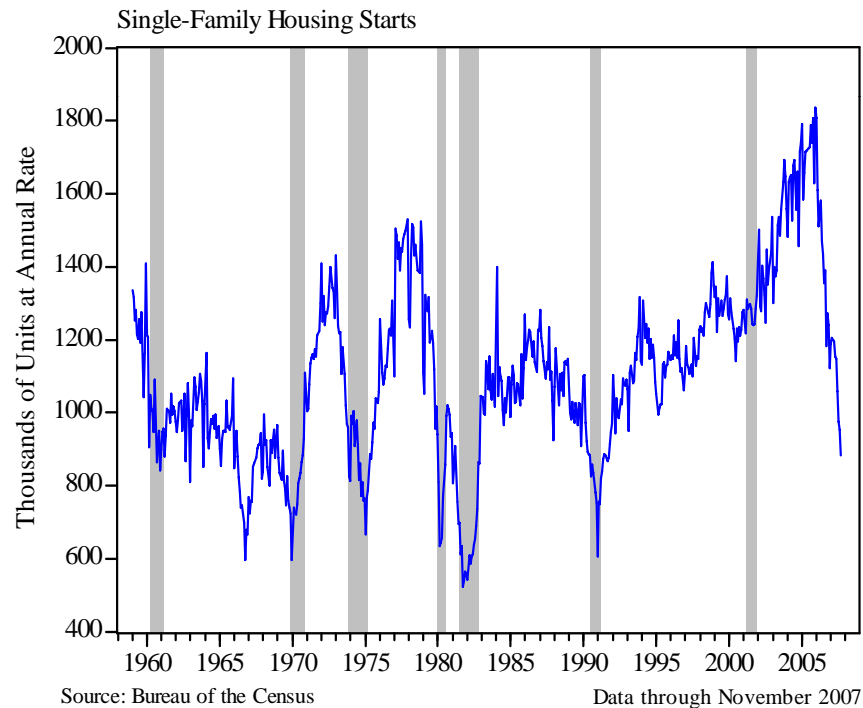
The U.S. Business Cycle in Perspective

Leading Indicators and Consumer Confidence



The U.S. Business Cycle in Perspective

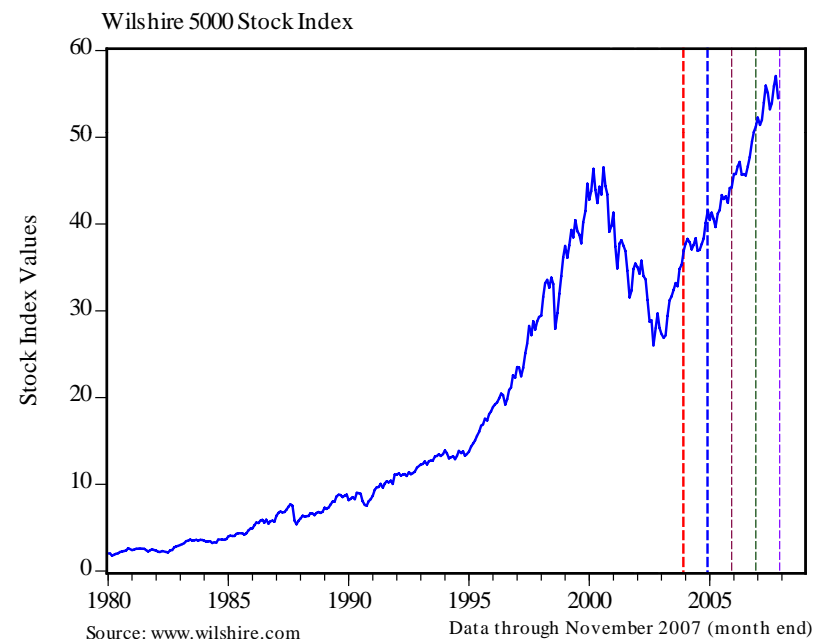
Light Vehicle Sales and Housing



The U.S. Business Cycle in Perspective

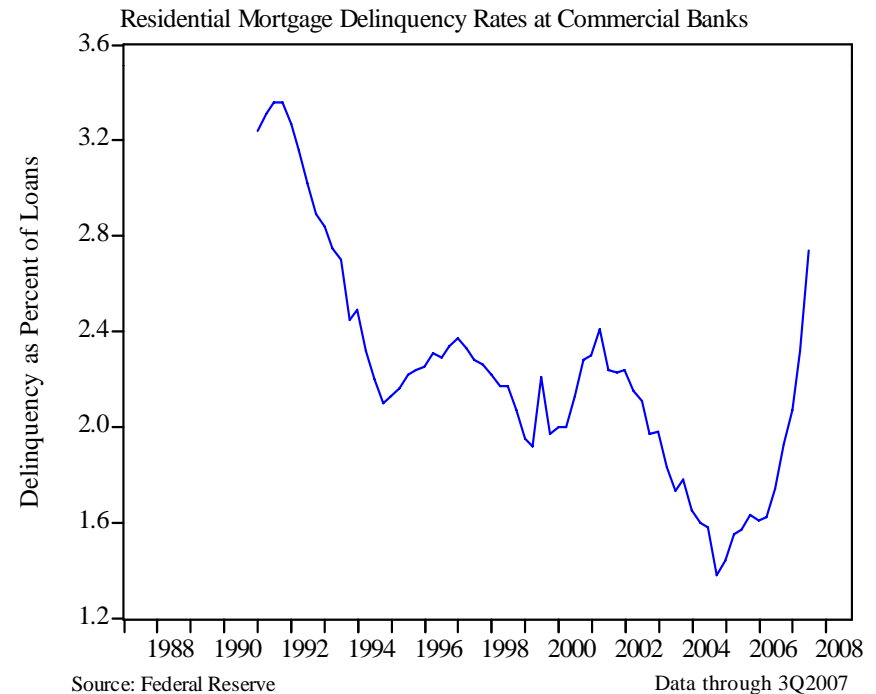
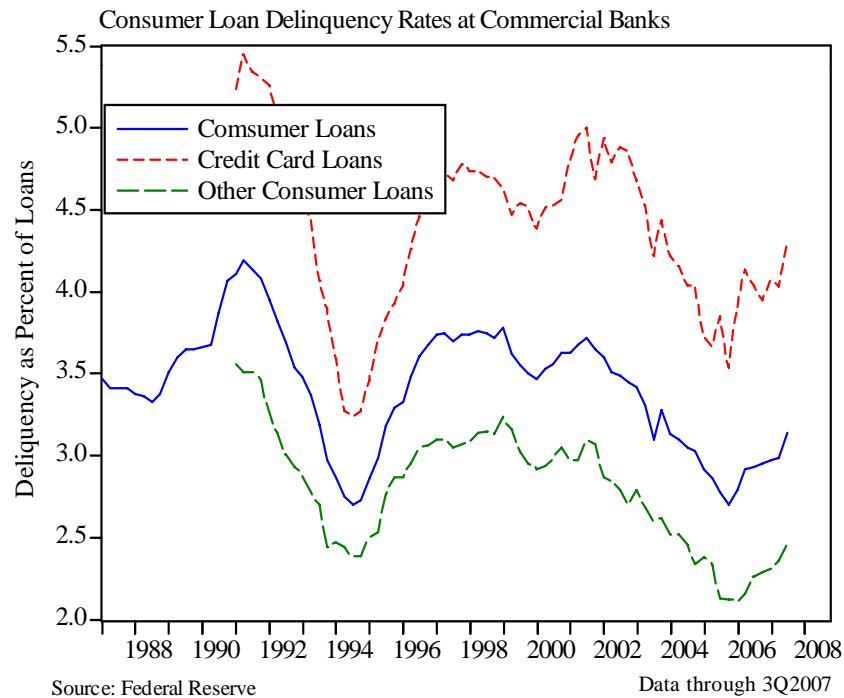
Equity Prices

- 2007 will be the fifth year to post a December-to-December gain
- But the year-end level will be beneath the peak for the year
- Generally, wealth effect has had minimal effect on spending in the short run
- However, it can affect consumer confidence/sentiment
- That can have a ripple effect on spending, particularly if other factors weigh heavily:
- Iraq,
 - Nuclear trouble spots: Pakistan, Iran, and North Korea
 - Perception of policy paralysis
 - Global concerns over uncertainty of extent of the subprime problem
- Early stage of foreign central banks' diversification efforts will not directly affect equity prices but may have an indirect effect through the dollar



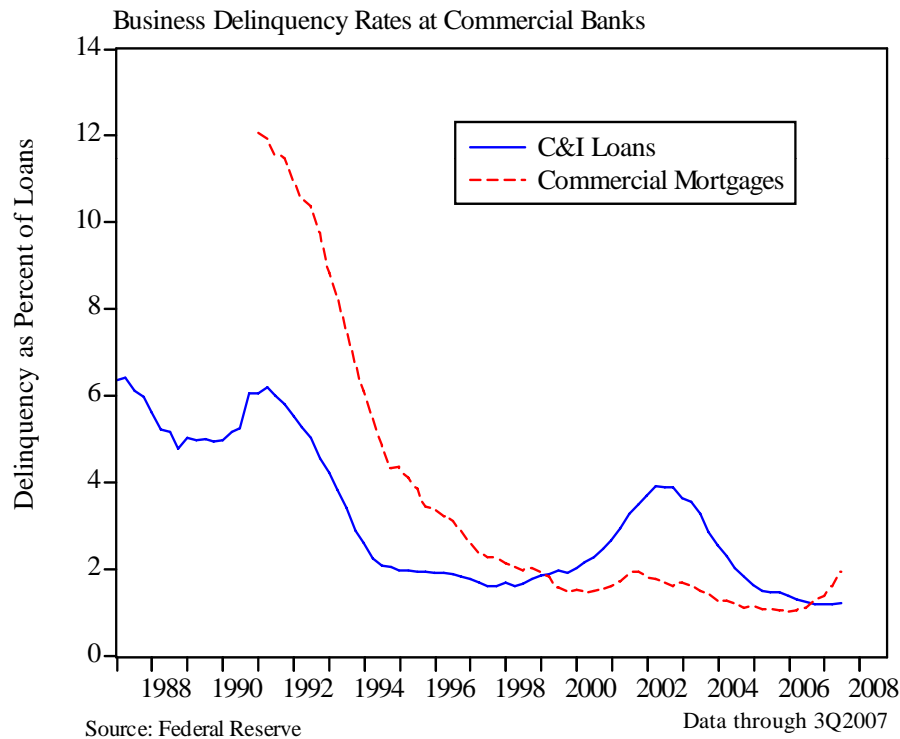
The U.S. Business Cycle in Perspective

Household Delinquency Rates at Commercial Banks



The U.S. Cycle in Perspective

Business Delinquency Rates at Commercial Banks



C&I loan delinquencies continue their decline

Commercial real estate delinquencies

- did not turn upward during the 2000 recession

- But have inched up this year

Looking forward, there is some question as to the lending capacity of banks

- Earnings at big banks affected by Level 3 asset value

- Capital at big banks may constrain lending

- The Federal Reserve has injected liquidity

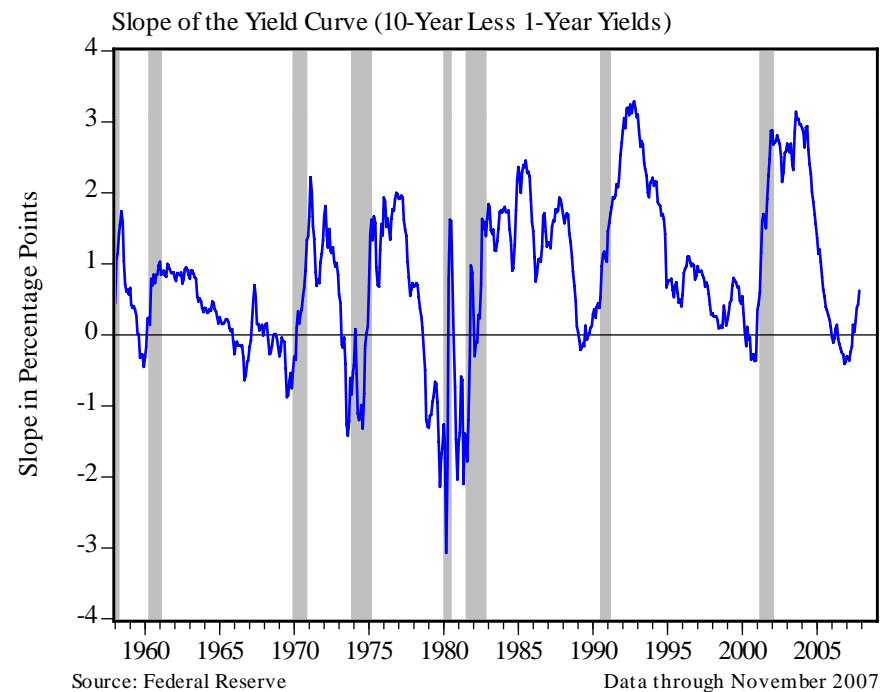
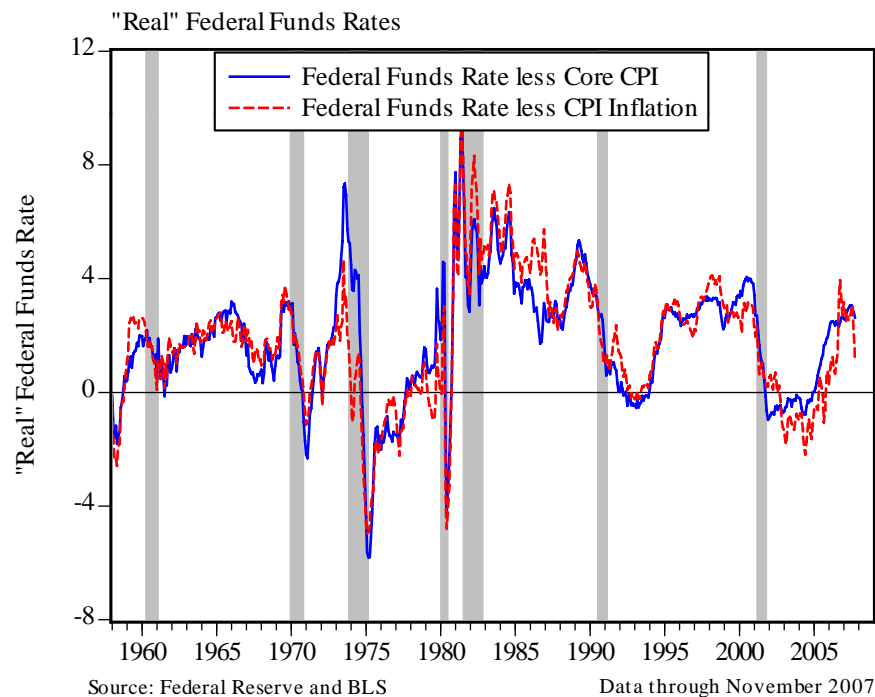
- But banks seem to be protecting their liquidity

- Bottom line – Situation is more “iffy” than a year ago

Positive: Federal Reserve has and will attempt to re-liquify the economy

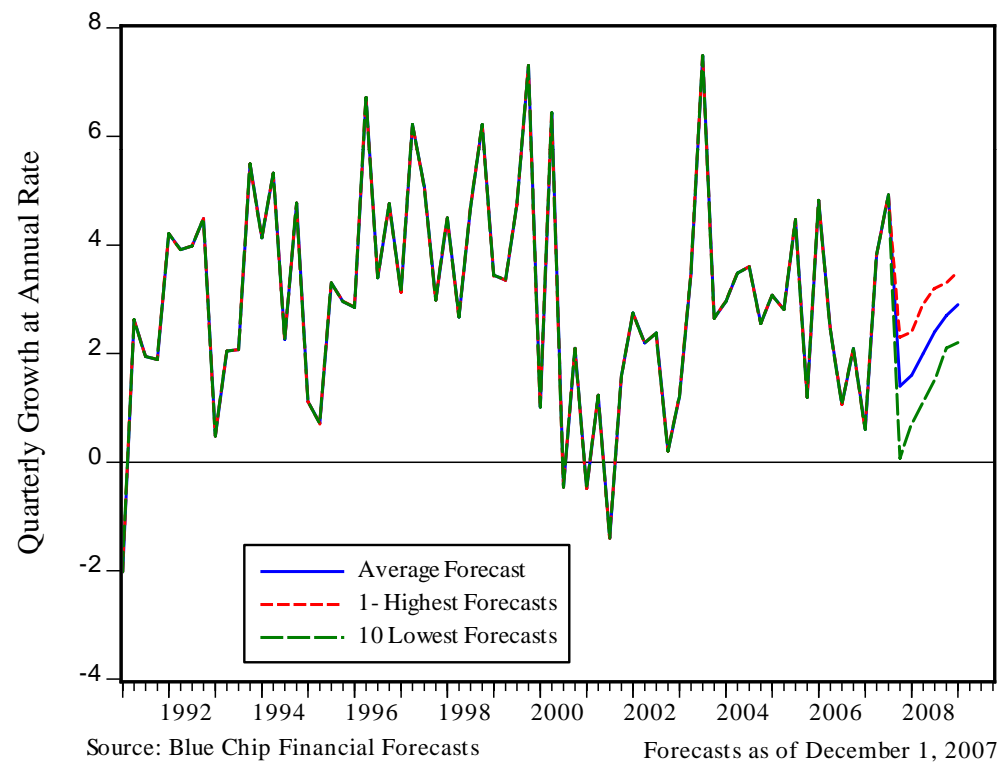
The U.S. Outlook – Setting the Stage

The Interest Rate Regime



The U.S. Outlook – Graphic Portrayal

Blue Chip Short-Term Economic Forecasts



Baseline U.S. Outlook

Table 1

	2007				2008				2009				Year-over-Year Growth		
	I(A) 2007	II(A) 2007	III(A) 2007	IV(E) 2007	II(E) 2008	III(E) 2008	IV(E) 2008	I(E) 2009	II(E) 2009	III(E) 2009	IV(E) 2009		2007	2008	2009
1 Gross Domestic Product	13551.9	13768.8	13967.3	14146.1	14315.1	14475.4	14653.1	14833.9	15033.5	15243.5	15458.4	15674.6	5.0	5.1	5.4
2 Change *	5.3	5.3	5.3	5.2	4.9	4.6	5.0	5.0	5.5	5.7	5.8	5.7			
3 Gross Dom. Product (96\$)	11412.6	11520.1	11659.3	11739.0	11808.0	11871.7	11948.7	12028.1	12121.6	12222.5	12326.0	12429.2	2.3	2.9	3.0
4 Change *	0.6	3.8	4.9	2.8	2.4	2.2	2.6	2.7	3.1	3.4	3.4	3.4			
5 Personal Consump. Exp. (96\$)	8215.7	8244.3	8238.5	8366.6	8415.2	8457.2	8505.9	8560.1	8622.1	8693.2	8767.2	8837.7	2.9	2.5	2.9
6 Change *	3.7	1.4	2.7	3.3	2.3	2.0	2.3	2.6	2.9	3.3	3.2	3.5	3.3		
7 Equipment and Software (96\$)	1045.3	1057.4	1075.9	1085.4	1093.7	1098.8	1105.9	1114.6	1126.2	1140.6	1155.7	1171.1	1.5	3.5	4.1
8 Change *	0.3	4.7	7.2	3.6	3.1	1.9	2.6	3.2	4.2	5.2	5.4	5.5	5.5		
9 Nonresid. Construction (96\$)	282.6	299.5	309.7	310.3	308.8	307.6	303.1	299.6	298.6	298.7	298.4	298.9	11.9	1.4	-2.0
10 Change *	6.3	28.2	14.3	0.8	-2.0	-1.5	-5.7	-4.5	-1.4	0.2	-0.4	0.7	0.7		
11 Resid. Construction (96\$)	506.3	490.7	464.5	446.2	437.0	432.1	429.3	430.8	434.7	438.4	444.2	452.1	-16.3	-9.4	2.3
12 Change *	-16.3	-11.8	-19.7	-14.9	-8.0	-4.4	-2.6	1.5	3.7	3.4	5.4	7.4			
13 Federal Defense (96\$)	491.6	501.7	513.9	514.0	516.0	517.0	518.2	519.4	520.5	521.7	522.9	524.1	2.8	2.4	0.9
14 Change *	-10.8	8.5	10.1	0.1	1.6	0.7	1.0	0.9	0.9	0.9	0.9	0.9			
15 Fed. Nondefense (96\$)	248.4	244.9	249.5	251.0	252.7	254.3	256.0	257.4	259.0	260.7	262.5	264.2	-0.5	2.3	2.6
16 Change *	3.8	0.8	1.0	2.5	2.7	2.6	2.7	2.1	2.6	2.6	2.6	2.6			
17 State + Local (96\$)	1284.2	1263.5	1270.0	1277.1	1284.2	1291.3	1298.5	1305.6	1312.9	1320.1	1327.5	1334.8			
18 Change *	3.0	3.0	2.1	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.3	2.2
19 Net Exports (96\$)	-612.1	-573.9	-533.4	-530.5	-520.6	-508.9	-499.0	-491.0	-484.8	-483.4	-484.8	-486.3			
20 Chg. in Bus. Invent. (96\$)	0.1	5.8	32.9	18.7	21.1	22.2	30.9	31.6	32.3	32.4	32.5	32.6			
21 Nonfarm Inventories	-5.8	1.3	29.8	18.4	21.9	23.2	31.7	32.3	33.0	33.2	33.3	33.3			
22 Farm Inventories	5.0	3.6	3.0	0.3	-0.9	-1.0	-0.8	-0.7	-0.7	-0.7	-0.7	-0.7			
23 GNP Deflator (96=100) *	4.2	2.6	0.9	2.4	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.6	2.2	2.3
24 CPI (1982=100) *	3.8	6.0	1.9	2.5	2.8	2.6	2.6	2.5	2.5	2.5	2.5	2.5	2.7	2.7	2.5
25 PPI (1982=100) *	6.7	10.0	0.8	2.3	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	3.4	2.7	2.5

Cyclical Characteristics

Table 2

	2007				2008				2009				Year-over-Year Growth		
	I(A) 2007	II(A) 2007	III(A) 2007	IV(E) 2007	II(E) 2008	III(E) 2008	IV(E) 2008	I(E) 2009	II(E) 2009	III(E) 2009	IV(E) 2009		2007	2008	2009
1 Domestic Final Sales (96\$)	12024.6	12088.2	12159.8	12250.8	12307.6	12358.4	12416.9	12487.5	12574.1	12673.5	12778.3	12883.0	2.3	1.9	3.2
2 Change *	1.7	2.1	2.4	3.0	1.9	1.7	1.9	2.3	2.8	3.2	3.3	3.3			
3 Cyclical Domestic Demand (96\$)	3057.4	3076.0	3090.5	3082.1	3087.1	3087.7	3094.6	3112.2	3142.9	3184.6	3229.3	3272.6	0.2	0.6	3.6
4 Change *	1.0	2.5	1.9	-1.1	0.7	0.1	0.9	2.3	4.0	5.4	5.7	5.5			
5 Cyclical Consumer Demand (96\$)	1223.2	1228.4	1240.4	1240.2	1247.7	1249.2	1256.3	1267.2	1283.4	1306.9	1331.1	1350.4	4.5	1.8	5.0
6 Change *	8.8	1.7	4.0	-0.1	2.4	0.5	2.3	3.5	5.2	7.5	7.6	5.9			
7 Light Vehicles and Parts (96\$)	444.5	441.5	437.7	432.7	434.8	431.7	432.3	435.6	442.1	454.6	465.7	472.3	1.1	-1.3	5.8
8 Change *	9.2	-2.7	-3.4	-4.5	2.0	-2.9	0.5	3.1	6.2	11.7	10.1	5.8			
9 Other Durables (96\$)	778.7	786.9	802.7	807.5	812.8	817.5	824.0	831.6	841.3	852.3	865.4	878.1	6.4	3.5	4.6
10 Change *	8.6	4.3	8.3	2.4	2.7	2.3	3.2	3.7	4.7	5.4	6.3	6.0			
11 Fixed Investment (96\$)	1815.2	1829.3	1827.5	1841.9	1839.5	1838.5	1838.3	1845.1	1859.5	1877.7	1898.3	1922.2	-2.5	0.6	2.7
12 Change *	4.8	4.9	4.9	3.2	-0.5	-0.2	0.0	1.5	3.2	4.0	4.5	5.1			
13 Resid. Construction (96\$)	506.3	490.7	464.5	446.2	437.0	432.1	429.3	430.8	434.7	438.4	444.2	452.1	-16.3	-9.4	2.3
14 Change *	-16.3	-11.8	-19.7	-14.9	-8.0	-4.4	-2.6	1.5	3.7	3.4	5.4	7.4			
15 Nonresid. Construction (96\$)	282.6	299.5	309.7	310.3	308.8	307.6	303.1	299.6	298.6	298.7	298.4	298.9	11.9	1.4	-2.0
16 Change *	6.3	28.2	14.3	0.8	-2.0	-1.5	-5.7	-4.5	-1.4	0.2	-0.4	0.7	0.7		
17 Equipment and Software (96\$)	1045.3	1057.4	1075.9	1085.4	1093.7	1098.8	1105.9	1114.6	1126.2	1140.6	1155.7	1171.1	1.5	3.5	4.1
18 Change *	0.3	4.7	7.2	3.6	3.1	1.9	2.6	3.2	4.2	5.2	5.4	5.5			
19 Noncyclical Demand (96\$)@	8355.2	8444.1	8568.8	8656.9	8720.9	8783.9	8854.1	8915.8	8978.7	9037.9	9096.7	9156.6	3.1	3.7	2.8
20 Change *	0.5	4.3	6.0	4.2	3.0	2.9	3.2	2.8	2.9	2.7	2.6	2.7			
21 Chg. in Business Inventories	0.1	5.8	32.9	18.7	21.1	22.2	30.9	31.6	32.3	32.4	32.5	32.6			
22 Gross Domestic Purchases (96\$)&	12044.7	12112.5	12215.4	12269.5	12328.7	12380.6	12447.7	12519.1	12606.4	12705.9	12810.8	12915.5	1.7	2.1	2.7
23 Change *	1.2	2.3	3.4	1.8	1.9	1.7	2.2	2.3	2.8	3.2	3.3	3.3			
24 Net Exports (96\$)	-612.1	-573.9	-533.4	-530.5	-520.6	-508.9	-499.0	-491.0	-484.8	-483.4	-484.8	-486.3			
25 GDP (96\$)**	11412.6	11520.1	11659.3	11739.0	11808.0	11871.7	11948.7	12028.1	12121.6	12222.5	12326.0	12429.2	2.3	2.9	3.0
Change *	0.6	3.8	4.9	2.8	2.4	2.2	2.6	2.7	3.1	3.4	3.4	3.4			

@ Noncyclical Demand = Consumer spending on nondurable goods and services and all forms of government spending (excluding CCC inventories)

& Gross Domestic Purchases = Domestic final demand plus Change *

* Quarter-to-quarter Percent Change *

A = Actual; E = Forecast Except for price indexes, all data in billions of dollars

Historical sources: BEA and BLS

December 5, 2007

Household Sector

	2007				2008				2009				Year-over-Year Growth		
	I(A) 2007	II(A) 2007	III(A) 2007	IV(E) 2007	II(E) 2008	III(E) 2008	IV(E) 2008	I(E) 2009	II(E) 2009	III(E) 2009	IV(E) 2009	2007	2008	2009	
1 Personal Income (\$ Bil.)	11468.2	11577.3	11741.8	11890.9	12037.4	12176.3	12318.9	12471.1	12633.9	12808.5	12988.7	13170.8	6.2	5.0	5.3
2 Change *	10.0	3.8	5.8	5.2	5.0	4.7	4.8	5.0	5.3	5.6	5.7				
3 Civilian Employment (Mil.)	146.0	146.0	146.1	146.3	146.6	146.8	147.1	147.4	147.8	148.3	148.8	149.3	1.2	0.6	1.0
4 Change *	1.1	-0.2	0.3	0.7	0.8	0.8	0.7	0.7	0.9	1.0	1.3	1.4	1.4		
5 Unemployment Rate	4.5	4.5	4.6	4.7	4.8	4.9	5.0	5.0	5.0	4.9	4.9	4.9			
6 Personal Consump. Exp. ('96\$)	8215.7	8244.3	8298.5	8366.8	8415.2	8457.2	8505.9	8560.1	8622.1	8693.2	8767.2	8837.7	2.9	2.5	2.9
7 Change *	3.7	1.4	2.7	3.3	2.3	2.0	2.3	2.6	2.9	3.3	3.5	3.3			
8 Autos & Parts	444.5	441.5	437.7	432.7	434.8	431.7	432.3	435.6	442.1	454.6	465.7	472.3	1.1	-1.3	5.8
9 Change *	9.2	-2.7	-3.4	-4.5	2.0	-2.9	0.5	3.1	6.2	11.7	10.1	5.8			
10 Other Durable Goods	778.7	786.9	802.7	807.5	812.8	817.5	824.0	831.6	841.3	852.3	865.4	878.1	6.4	3.5	4.6
11 Change *	8.6	4.3	8.3	2.4	2.7	2.3	3.2	3.7	4.7	5.4	6.3	6.0			
12 Nondurable Goods	2386.6	2383.8	2394.9	2405.8	2414.6	2424.0	2434.1	2445.6	2459.0	2473.6	2490.0	2507.3	2.4	1.5	2.2
13 Change *	3.0	-0.5	1.9	1.8	1.5	1.6	1.7	1.9	2.2	2.4	2.7	2.8			
14 Services	4630.7	4656.7	4688.8	4720.8	4752.9	4784.1	4815.5	4847.3	4879.7	4912.7	4946.1	4980.0	2.8	2.7	2.7
15 Change *	3.1	2.3	2.8	2.8	2.8	2.6	2.7	2.7	2.7	2.7	2.8	2.8			
16 Lt. Vehicles	16.4	16.0	15.9	15.6	15.7	15.5	15.4	15.4	15.6	15.9	16.2	16.3	-3.1	-3.2	3.2
17 Change *	3.4	-9.4	-4.2	-5.5	0.3	-4.8	-1.6	0.6	3.4	8.8	7.3	3.0			
18 New Auto Sales (Mil.)	7.6	7.7	7.3	7.4	7.4	7.3	7.3	7.3	7.4	7.5	7.7	7.7	-3.5	-2.0	3.2
19 Change *	-3.4	5.6	-16.4	4.8	0.3	-4.8	-1.6	0.6	3.4	8.8	7.3	3.0			
20 New Light Truck Sales (Mil.)	8.9	8.4	8.5	8.2	8.2	8.1	8.1	8.1	8.2	8.3	8.5	8.6	-2.7	-4.2	3.2
21 Change *	2.3	-5.7	2.0	-3.6	0.1	-1.2	-0.4	0.2	0.8	2.1	1.8	0.7			
22 Private Housing Starts (Mil.)	1,460	1,464	1,304	1,150	1,155	1,147	1,191	1,284	1,362	1,418	1,517	1,603	-25.8	-11.6	24.0
23 Change *	-22.1	1.1	-37.2	-39.4	1.8	-2.8	16.0	26.8	34.8	17.5	31.3	24.6			
24 Single-Family	1,172	1,166	0,995	0,900	0,900	0,925	0,950	1,025	1,100	1,150	1,225	1,300			
25 Multi-Family	0,288	0,299	0,308	0,250	0,255	0,222	0,241	0,239	0,262	0,268	0,292	0,303			
26 Existing Home Sales (Th.)	6423.3	5916.7	5423.3	5517.2	5523.1	5636.2	5704.1	5884.4	6031.0	6149.8	6319.2	6476.4	-10.3	-2.3	9.8
27 Change *	10.6	-28.0	-29.4	7.1	0.4	8.4	4.9	13.3	10.3	8.1	11.5	10.3			

Corporate Sector

	2007				2008				2009				Year-over-Year Growth			
	I(A)	II(A)	III(A)	IV(E)	II(E)	III(E)	IV(E)	I(E)	II(E)	III(E)	IV(E)	2007	2008	2009		
1	Fixed Business Invest. ('96\$)	1321.7	1356.6	1387.5	1395.7	1402.4	1406.4	1409.0	1414.3	1424.8	1439.3	1454.1	1470.1	4.5	3.1	2.8
2	Change *	5.4	5.4	5.4	2.4	1.9	1.1	0.7	1.5	3.0	4.2	4.2	4.5			
3	Structures	282.6	299.5	309.7	310.3	308.8	307.6	303.1	299.6	298.7	298.4	298.9	298.9	11.9	1.4	-2.0
4	Change *	6.3	26.2	14.3	0.8	-2.0	-1.5	-5.7	-4.5	-1.4	0.2	-0.4	0.7			
5	Producer Equip. & Software	1045.3	1057.4	1075.9	1085.4	1093.7	1098.8	1105.9	1114.6	1126.2	1140.6	1155.7	1171.1	1.5	3.5	4.1
6	Change *	0.3	4.7	7.2	3.6	3.1	1.9	2.6	3.2	4.2	5.2	5.4	5.5			
7	Chg. in Bus. Invent. ('96\$)	0.1	5.8	32.9	18.7	21.1	22.2	30.9	31.6	32.3	32.4	32.5	32.6			
8	Chg. in Nonfarm Inventories	-5.8	1.3	29.8	18.4	21.9	23.2	31.7	32.3	33.0	33.2	33.3	33.3			
9	Corporate Profits (B.T.)	1815.8	1931.5	1879.5	1816.3	1846.7	1869.6	1883.7	1897.9	1923.9	1952.8	1982.6	2014.8			
10	Corporate Profits (A.T.)	1363.3	1441.4	1408.6	1362.2	1385.0	1402.2	1412.8	1423.4	1442.9	1464.6	1487.0	1511.1	3.1	0.9	5.0
11	Change *	8.2	25.0	-8.8	-12.5	6.9	5.1	3.1	3.0	5.6	6.1	6.3	6.7			
12	Internal Funds (A.T.)	839.2	853.5	815.7	793.2	793.5	799.4	799.8	800.9	802.9	805.1	807.3	810.2	-5.5	-3.3	1.0
13	Change *	9.8	7.0	-16.6	-10.6	0.1	3.0	0.2	0.5	1.0	1.1	1.1	1.4			
14	Dividends	759.4	784.2	807.7	828.6	848.1	867.7	888.1	908.8	931.1	954.0	977.9	1002.5	13.7	10.5	10.0
15	Change *	13.1	13.7	12.5	10.7	9.8	9.5	9.8	9.7	10.1	10.2	10.4	10.5			
16	Output per Hour *	0.2	3.6	5.3	2.3	1.7	1.7	2.2	2.1	2.4	2.4	2.4	2.3	1.6	2.5	2.3
17	Hourly Compensation *	4.2	4.2	4.2	5.1	3.1	3.4	3.9	4.1	4.3	4.6	4.5	4.4	5.7	4.1	4.3
18	Unit Labor Costs *	5.3	2.2	-0.2	2.8	1.4	1.7	1.8	2.1	1.9	2.1	2.1	2.1	4.0	1.7	2.0

International Sector

	2007				2008				2009				Year-over-Year Growth	
	I(A) 2007	II(A) 2007	III(A) 2007	IV(E) 2007	II(E) 2008	III(E) 2008	IV(E) 2008	I(E) 2009	II(E) 2009	III(E) 2009	IV(E) 2009	2007	2008	2009
1 Net Exports ('96\$)	-612.1	-573.9	-533.4	-530.5	-520.6	-508.9	-499.0	-491.0	-484.8	-483.4	-484.8	-486.3	8.5	11.6
2 Exports ('96\$)	1354.7	1379.5	1440.4	1485.2	1524.7	1562.2	1598.3	1633.8	1668.9	1703.6	1730.0	1773.1	8.9	
3 Change *	1.1	7.5	18.9	13.0	11.1	10.2	9.6	9.2	8.9	8.6	8.3	8.3		
4 Imports ('96\$)	1966.8	1953.4	1973.8	2015.7	2045.3	2071.1	2097.3	2124.8	2153.6	2187.0	2222.8	2259.4	2.5	5.4
5 Change *	3.9	-2.7	4.2	8.8	6.0	5.1	5.2	5.3	5.5	6.3	6.7	6.8	5.8	
Trade-Weighted Index	81.9	79.3	77.0	77.5	78.5	79.4	80.2	81.0	81.6	82.3	82.8	83.3	-4.3	1.0
													3.4	

Except where noted, all data in billions of dollars
* Quarter-to-quarter percent changes expressed at compound annual rates
A = Actual; E = Forecast

Historical sources: BEA, BLS, and Federal Reserve

December 5, 2007

Table 3

Table 4

Table 5



Outlook for Interest Rates

Market-Based Forecasts: Futures Market over the Next Year

Futures market sees a cuts in the federal funds rate through late 2008

- Accuracy of such forecasts is marginal at best

Nonetheless, this view is reflected in long-term Treasury yields

- Current short-term yields have “built in” significant cuts in the federal funds target rate
- Current short-term yields may also reflect flight to quality which can corrupt the forecast content of the spread between the federal funds rate and other short-term rates

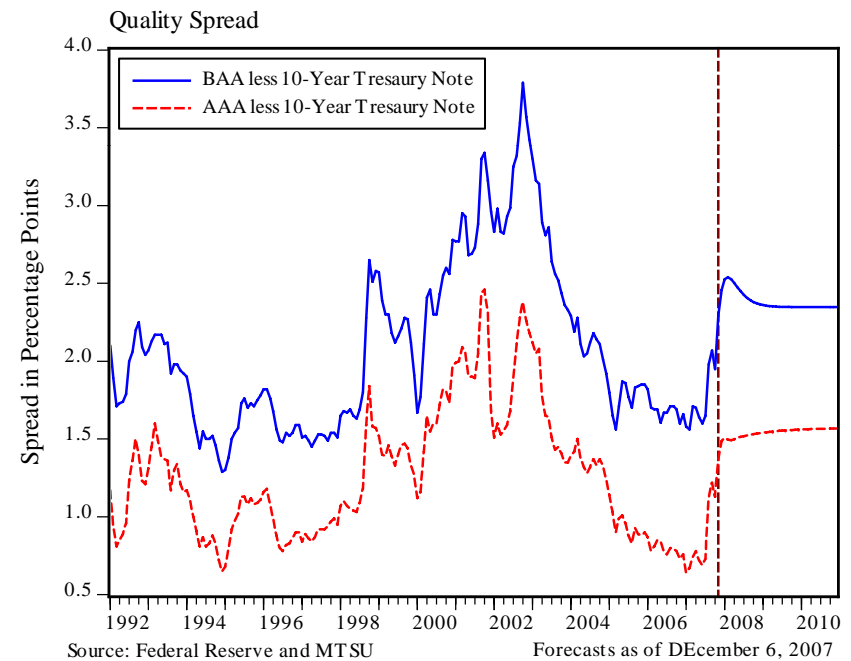
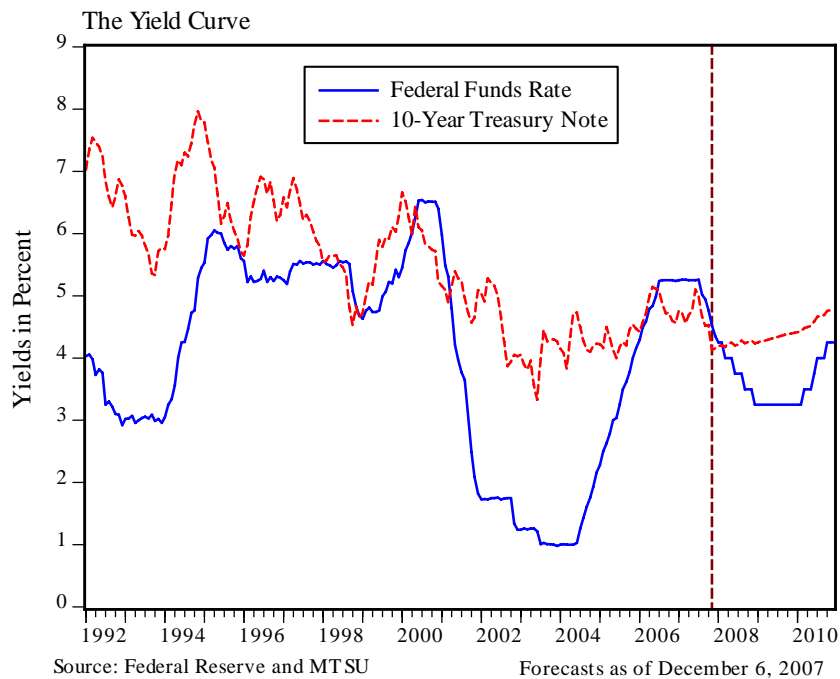
Forecasts Using Futures Contracts

Contract Date	Settlement Price	Implicit Interest Rate
Dec-07	95.755	4.245
Jan-08	95.86	4.14
Feb-08	96.055	3.945
Mar-08	96.145	3.855
Apr-08	96.235	3.765
May-08	96.395	3.605
Jun-08	96.415	3.585
Jul-08	96.56	3.44
Aug-08	96.67	3.33
Sep-08	96.75	3.25

Source: cbot.com as of 12/5/07

Interest Rate Outlook – Graphic Portrayal

MTSU Baseline Interest Rate Forecast



Money Market Interest Rates

Table 6

	2007				2008				2009				Annual Averages		
	I(A) 2007	II(A) 2007	III(A) 2007	IV(E) 2007	I(E) 2008	II(E) 2008	III(E) 2008	IV(E) 2008	I(E) 2009	II(E) 2009	III(E) 2009	IV(E) 2009	2007	2008	2009
1 Federal Funds	5.26	5.25	5.07	4.55	4.25	4.00	3.75	3.58	3.50	3.50	3.50	3.50	5.03	3.90	3.50
Commercial Paper															
2 1-Month	5.22	5.23	5.14	4.51	4.28	4.25	4.24	4.24	4.04	4.04	4.04	4.05	5.03	4.25	4.03
3 3-Month	5.19	5.22	5.14	4.45	4.22	4.20	4.14	4.13	4.03	3.98	4.00	3.99	5.00	4.17	4.00
4 6-Month	5.18	5.21	5.13	4.46	4.25	4.19	4.14	4.15	4.03	3.98	4.00	4.00	5.00	4.18	4.00
Finance Paper															
5 1-Month	5.24	5.24	5.19	4.54	4.27	4.24	4.24	4.22	4.01	3.97	4.02	4.02	5.05	4.24	4.00
6 3-Month	5.23	5.24	5.20	4.59	4.24	4.21	4.16	4.15	4.04	4.00	4.02	4.01	5.07	4.19	4.02
7 6-Month	5.23	5.24	5.25	4.78	4.48	4.33	4.19	4.20	4.07	4.01	4.00	3.98	5.12	4.30	4.02
Treasury Bills															
8 1-Month	5.12	4.87	4.42	3.59	3.66	3.72	3.63	3.58	3.52	3.52	3.56	3.54	4.50	3.65	3.53
9 3-Month	5.14	5.00	4.60	3.77	3.83	3.88	3.80	3.75	3.70	3.71	3.74	3.73	4.63	3.82	3.72
Negotiable CDs															
10 1-Month	5.28	5.29	5.42	4.74	4.25	4.19	4.35	4.33	3.93	3.88	4.06	4.06	5.18	4.28	3.98
11 3-Month	5.31	5.32	5.42	4.93	4.45	4.25	4.23	4.39	4.26	4.13	4.10	4.01	5.24	4.33	4.13
12 6-Month	5.32	5.33	5.36	4.85	4.56	4.44	4.48	4.38	4.20	4.20	4.23	4.16	5.22	4.47	4.20
Eurodollar Deposit															
13 1-Month	5.32	5.32	5.45	4.78	4.26	4.18	4.34	4.34	3.93	3.87	4.04	4.06	5.22	4.28	3.98
14 3-Month	5.35	5.34	5.47	4.99	4.49	4.28	4.24	4.41	4.28	4.14	4.11	4.03	5.29	4.35	4.14
15 6-Month	5.36	5.36	5.38	4.90	4.40	4.30	4.54	4.36	4.05	4.18	4.26	4.09	5.25	4.40	4.14
16 Prime Rate	8.25	8.25	8.18	7.53	7.25	7.00	6.75	6.58	6.50	6.50	6.50	6.50	8.05	6.90	6.50

Capital Market Instruments

Table 7

	2007				2008				2009				Annual Averages		
	I(A) 2007	II(A) 2007	III(A) 2007	IV(E) 2007	I(E) 2008	II(E) 2008	III(E) 2008	IV(E) 2008	I(E) 2009	II(E) 2009	III(E) 2009	IV(E) 2009	2007	2008	2009
U.S. Treasury Notes and Bonds															
1 1-Yr Note	5.01	4.93	4.52	3.76	3.91	3.88	3.82	3.78	3.73	3.74	3.77	3.76	4.56	3.85	3.75
2 2-Yr Note	4.77	4.81	4.38	3.55	3.58	3.66	3.64	3.64	3.63	3.67	3.72	3.74	4.38	3.63	3.69
3 5-Yr Note	4.65	4.76	4.50	3.83	3.76	3.81	3.83	3.86	3.90	3.96	4.03	4.09	4.44	3.82	3.99
4 10-Yr Note	4.68	4.85	4.73	4.27	4.21	4.25	4.27	4.30	4.32	4.37	4.41	4.45	4.63	4.25	4.39
5 30-Yr Note	4.90	5.07	5.01	4.65	4.70	4.71	4.63	4.70	4.71	4.70	4.76	4.77	4.91	4.69	4.74
Other Bonds															
6 AAA Bonds	5.36	5.58	5.75	5.60	5.71	5.75	5.79	5.83	5.87	5.92	5.97	6.01	5.57	5.77	5.94
7 BAA Bonds	6.30	6.49	6.63	6.50	6.74	6.72	6.67	6.67	6.68	6.72	6.76	6.80	6.48	6.70	6.74
8 State and Local	4.20	4.39	4.57	4.51	4.69	4.66	4.64	4.64	4.66	4.69	4.73	4.76	4.42	4.66	4.71
Mortgage Rates - Primary Mkt															
9 30-Yr (FHLMC - PMMS)	6.05	6.26	6.35	5.91	6.09	6.07	6.03	6.07	6.10	6.13	6.17	6.21	6.14	6.06	6.15
10 15-Yr (FHLMC - PMMS)	5.70	5.87	5.92	5.41	5.41	5.28	5.24	5.33	5.35	5.38	5.44	5.50	5.73	5.31	5.42
11 ARM (FHLMC - PMMS)	5.47	5.55	5.68	5.73	6.25	6.26	6.14	6.04	5.93	5.89	5.88	5.84	5.61	6.17	5.89
Mortgage Rates - Secondary Mkt															
12 30-Yr (FLHMC Reg Net Yield)	6.22	6.37	6.55	6.29	6.24	6.24	6.22	6.23	6.23	6.26	6.29	6.32	6.36	6.23	6.27
13 15-Yr (FLHMC Reg Net Yield)	5.96	6.06	6.21	5.96	6.00	5.98	5.94	5.92	5.90	5.91	5.93	5.94	6.05	5.96	5.92

Sources: Federal Reserve, Federal Home Loan Bank, Federal Home Loan Mortgage Corp.
A = Actual; E = Forecast

December 5, 2007

The Tennessee Cycle in Perspective

Personal Income – Tennessee versus U.S.

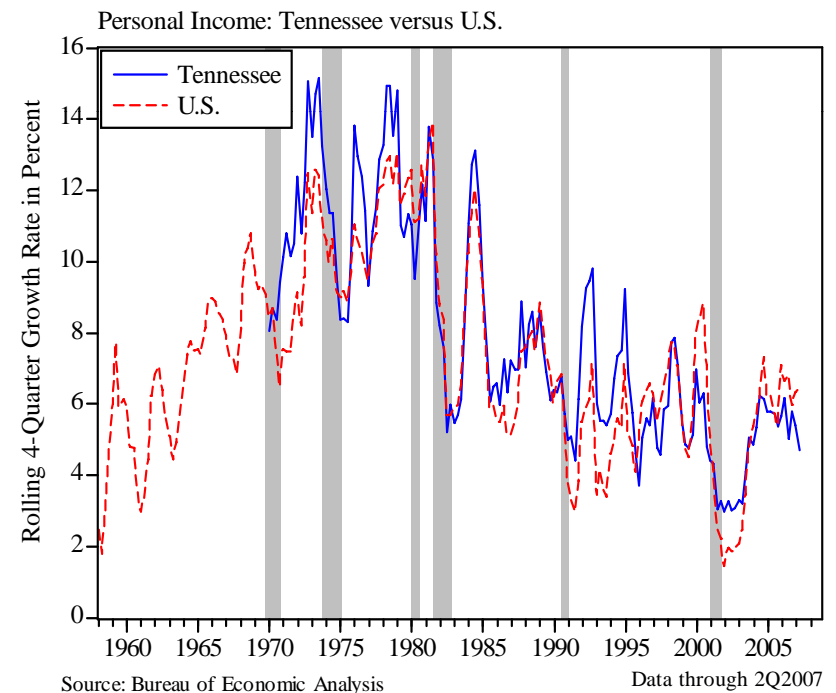
Quarterly growth in state and nation follows roughly the same cyclical pattern

- Over time, each 1% growth in U.S. personal income is met with 1% growth in Tennessee
- But there are sizeable short-run deviations

In the early days of the current expansion, Tennessee's growth was faster than that of the U.S.

Then the two series tracked each other closely for a few years

More recently, U.S. income growth has been marginally above Tennessee's



The Tennessee Cycle in Perspective

Labor Markets – Tennessee versus U.S.

Tennessee's growth pattern moves in a roughly similar cyclical pattern

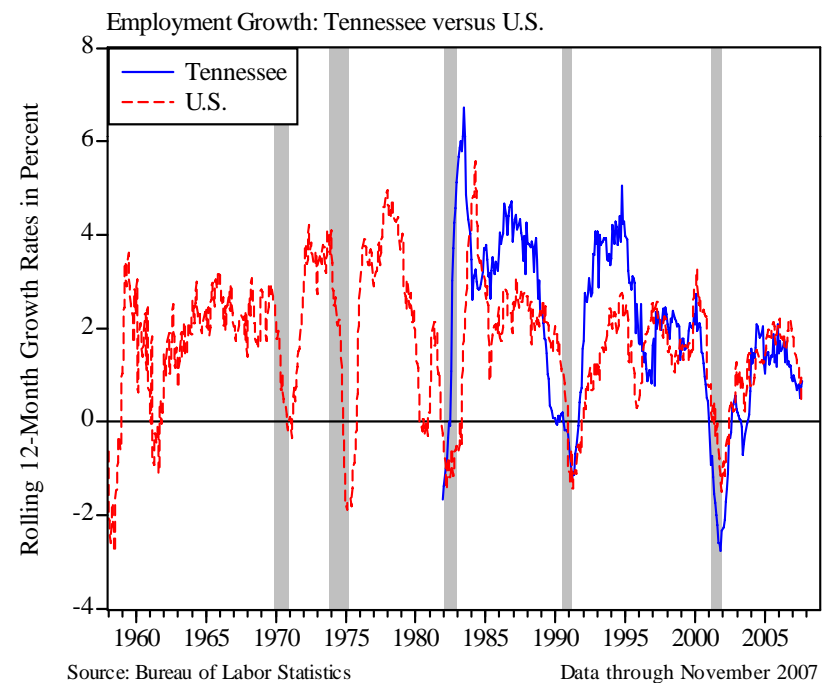
But differences are evident

Pattern has tighter co-movement as decline gathers momentum

In the early part of the common sample period, Tennessee typically had a stronger employment growth than the country as a whole in the upswing

But Tennessee and U.S. are moving into closer cyclical alignment in the past 10 years

More recently, Tennessee and U.S. move in tight tandem



The Tennessee Cycle in Perspective

Housing Activity – Tennessee versus U.S.

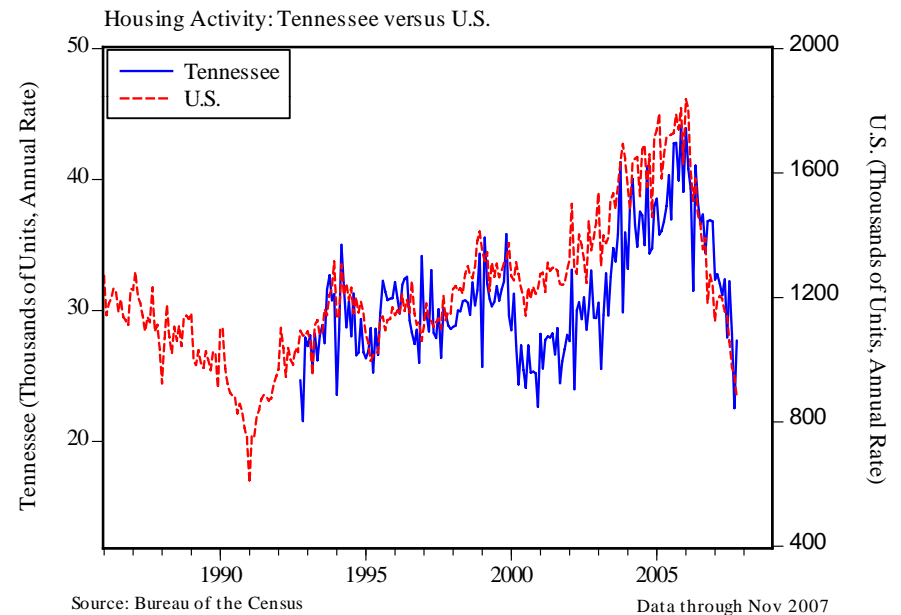
Housing in Tennessee generally moves with the U.S. housing cycle

- But there was break in the tightness of the relationship 2000-2004
- Tightness resumes in the late stage of the housing upswing and so far in the housing slump

Some saw the 2005-2006 housing boom as a potential bubble

- If so, both the volume of permits and valuation could be at risk
- Risk is at both the national level and the state level

In the past, downturn was more service in Tennessee than the country as a whole



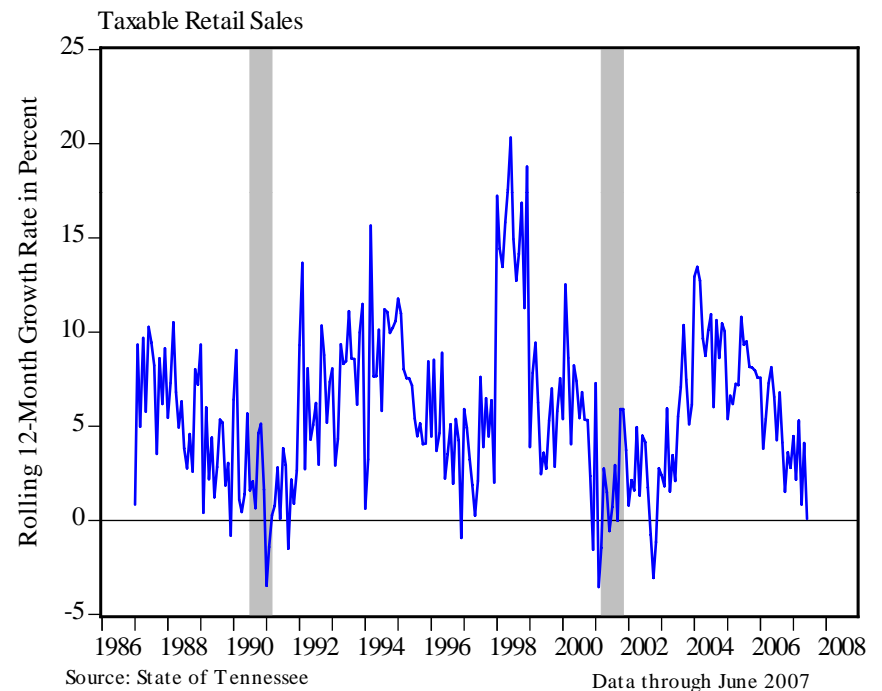
The Tennessee Cycle in Perspective

Consumer Spending

Recent deceleration in sales growth is akin
its behavior going into to the 1990 and
2001 recession

But it is too early to sale a recession in
imminent

Sales growth has temporarily faltered and
rebounded s on several occasions over
the 1986-2007 period



	2007				2008				2009				Year-over-Year Growth		
	I(A) 2007	II(A) 2007	III(A) 2007	IV(E) 2007	IE 2008	II(E) 2008	III(E) 2008	IV(E) 2008	I(E) 2009	II(E) 2009	III(E) 2009	IV(E) 2009	2007	2008	2009
National Trends															
1 Civilian Employment (Mil.)	146.0	146.0	146.1	146.3	146.6	146.8	147.1	147.4	147.8	148.3	148.8	149.3	1.2	0.6	1.0
2 Change *	1.1	-0.2	0.3	0.7	0.8	0.7	0.7	0.9	1.0	1.3	1.4	1.4	6.2	5.0	5.3
3 Personal Income	11469.2	11577.3	11741.8	11890.9	12037.4	12176.3	12318.9	12471.1	12633.9	12808.5	12988.7	13170.8			
4 Change *	10.0	3.8	5.8	5.2	5.0	4.7	4.8	5.0	5.3	5.6	5.7	5.7	5.0	4.3	4.2
5 Income Per Employee (T)	78.533	79.320	80.394	81.282	82.110	82.916	83.740	84.593	85.476	86.386	87.308	88.236			
6 Change *	8.7	4.1	5.5	4.5	4.1	4.0	4.0	4.1	4.2	4.3	4.3	4.3	5.0	4.3	4.2
7 Housing Starts (Mil. of Units)	1,460	1,464	1,304	1,150	1,155	1,147	1,191	1,264	1,362	1,418	1,517	1,603	-25.8	-11.6	24.0
8 Change *	-22.1	1.1	-37.2	-39.4	1.8	-2.8	16.0	26.8	34.8	17.5	31.3	24.6			
Tennessee															
9 Nonagricultural Employment (T)	2793.3	2800.7	2809.1	2810.2	2815.3	2822.0	2827.1	2833.1	2841.0	2850.2	2859.8	2869.1	0.7	0.7	1.1
10 Change *	1.0	0.2	1.2	0.2	0.7	1.0	0.7	0.9	1.1	1.3	1.3	1.3	5.2	5.3	5.6
11 Personal Income	201.2	203.7	206.7	209.4	212.1	214.8	217.5	220.4	223.4	226.6	229.9	233.2			
12 Change *	3.7	5.2	6.0	5.2	5.3	5.2	5.2	5.4	5.6	5.8	5.9	5.9	6.5	4.7	3.6
13 Dividends & Interest	24.4	24.9	25.3	25.7	25.9	26.1	26.4	26.6	26.8	27.1	27.3	27.6			
14 Change *	9.5	9.7	7.0	5.2	3.8	3.5	3.4	3.5	3.6	3.7	3.8	3.8			
15 Income Per Employee (T)	71.869	72.743	73.596	74.503	75.335	76.122	76.952	77.797	78.647	79.511	80.387	81.276	4.4	4.6	4.4
16 Change *	2.6	5.0	4.8	5.0	4.5	4.2	4.4	4.5	4.4	4.5	4.5	4.5			
17 Retail Sales	87.9	88.9	90.0	91.0	91.9	93.0	93.9	95.0	96.2	97.4	98.8	100.2	3.4	4.5	5.1
18 Change *	5.2	4.7	4.9	4.8	3.9	4.9	4.1	4.5	5.4	5.2	5.8	5.8			
19 Single-Family Building Permits (T)	32,397	30,495	27,662	27,639	27,663	27,555	27,482	27,875	28,740	29,104	30,283	31,238	-21.9	-6.4	8.0
20 Change *	-40.2	-21.5	-32.3	-0.3	0.3	-1.6	-1.1	5.8	13.0	5.2	17.2	13.2			

Note: Except where noted, all data in billions of dollars. Historic sources: BEA, BLS, State of Tennessee
T=Thousands of units, persons, or dollars
* Quarter-to-quarter percent changes expressed at compound annual rates.
A = Actual; E = Forecast

Prospects for Tax Revenue: Funding Board Estimates

Table 9

	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	FY06-07	FY07-08	FY08-09	FY09-10
1 Total Tax Revenue*	6373.7	6737.7	6979.4	7526.8	7656.4	7469.0	8449.7	9094.0	9638.6	10290.8	11052.7	11677.7		
2 Chg@	5.6	5.7	3.6	7.8	1.7	-2.4	13.1	7.6	6.0	6.8	7.4	5.7		
3 Sales and Use Tax*	3905.0	4099.9	4246.2	4600.7	4643.3	4645.7	5459.4	5810.8	6091.5	6515.6	6815.4	7093.3		
4 Chg@	6.1	5.9	6.0	5.9	0.9	0.1	17.5	6.4	4.8	7.0	4.6	4.1		
5 Income Tax*	128.3	161.3	160.4	179.9	199.4	141.7	102.9	140.0	155.9	194.4	247.6	263.2		
6 Chg@	11.3	25.8	-0.6	12.2	10.8	-28.9	-27.4	36.0	11.4	24.7	27.4	6.3		
7 Gross Receipts Tax*	188.2	188.8	197.5	213.1	248.6	224.3	216.5	219.1	235.9	241.2	277.6	284.4		
8 Chg@	7.0	0.3	4.6	7.9	16.6	-9.8	-3.5	1.2	7.6	2.2	15.1	2.4		
9 Excise plus Franchise Taxes*	893.3	906.2	891.2	1083.0	1102.8	966.3	1071.7	1197.8	1372.0	1491.6	1766.1	1820.9		
10 Chg@	9.2	1.4	-1.7	21.5	1.8	-12.4	10.9	11.8	14.5	8.7	18.4	3.1		
11 Gasoline Tax*	543.3	563.2	567.4	576.1	569.4	576.9	600.1	599.3	608.1	605.6	612.3	602.0		
12 Chg@	1.4	3.7	0.8	1.5	-1.2	1.3	4.0	-0.1	1.5	-0.4	1.1	-1.7		
13 Vehicle Registration*	183.6	195.7	201.2	218.6	211.4	219.6	225.0	238.5	244.2	249.5	257.4	260.0		
14 Chg@	-0.6	6.5	2.8	8.7	-3.3	3.9	2.5	6.0	2.4	2.2	3.1	1.0		
15 Fuel Tax*	126.8	133.2	142.5	152.8	173.4	151.2	155.4	167.7	173.7	180.7	185.9	189.0		
16 Chg@	0.2	5.0	7.0	7.2	13.5	-12.8	2.8	7.9	3.5	4.0	2.9	1.7		
17 Privilege Tax*	108.4	124.4	142.6	153.7	160.8	177.4	216.5	246.1	264.9	304.9	313.8	379.5		
18 Chg@	8.6	14.7	14.7	7.8	4.6	10.3	22.1	13.6	7.7	15.1	2.9	20.9		
19 All Other Taxes*	296.8	365.1	330.4	348.9	347.2	365.8	401.9	474.6	492.4	507.3	576.7	785.4		
20 Chg@	0.6	23.0	-9.5	5.6	-0.5	5.4	9.9	18.1	3.7	3.0	13.7	38.2		

Prospects for Tax Revenue: MTSU Forecast

Table 10

	Tennessee Economic Assumptions (Fiscal-Year Basis)												Forecasts	
	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	FY06-07	FY07-08	FY08-09	FY09-10
1 Personal Income (Bil \$)	121.6	128.9	137.0	144.9	152.0	156.8	161.8	169.7	179.6	190.5	200.7	210.3	222.1	234.7
2 Chg@	5.5	6.0	6.3	5.7	4.9	3.2	3.2	4.8	5.8	6.1	5.4	4.8	5.6	5.7
3 Nonagricultural Employment (Mil)	2,556	2,611	2,659	2,715	2,720	2,664	2,666	2,680	2,726	2,762	2,791	2,819	2,843	2,867
4 Chg@	1.4	2.1	1.9	2.1	0.2	-2.1	0.1	0.5	1.7	1.3	1.0	1.0	0.9	0.9
5 Income Per Employee (Th \$)	47.6	49.4	51.5	53.4	55.9	58.9	60.7	63.3	65.9	69.0	71.9	74.6	78.1	81.9
6 Chg@	4.0	3.8	4.4	3.6	4.7	5.3	3.1	4.3	4.1	4.7	4.3	3.7	4.7	4.8
7 Retail Sales (Bil \$)	48.3	53.5	58.8	62.6	64.1	65.9	67.0	73.1	78.1	82.9	87.2	91.0	95.6	100.5
8 Chg@	3.1	10.8	9.9	6.5	2.4	2.9	1.7	9.1	6.8	6.1	5.2	4.3	5.1	5.1
9 Building Permits (Th of Units)	29.2	29.4	31.2	29.7	26.3	28.0	30.2	36.0	37.2	40.2	35.0	35.6	37.9	38.2
10 Chg@	-6.8	0.7	6.0	-4.7	-11.4	6.4	8.0	19.0	3.4	8.0	-13.0	1.8	6.5	0.6

	FY96-97	FY97-98	FY98-99	FY99-00	FY00-01	FY01-02	FY02-03	FY03-04	FY04-05	FY05-06	FY06-07	FY07-08	FY08-09	FY09-10
11 Total Tax Revenue*	6,373.7	6,737.7	6,979.4	7,526.8	7,656.4	7,469.0	8,449.7	9,094.0	9,638.6	10,290.8	11,052.7	11,344.7	11,836.3	12,385.4
12 Chg@	5.6	5.7	3.6	7.8	1.7	-2.4	13.1	7.6	6.0	6.8	7.4	2.6	4.3	4.6
13 Sales and Use Tax*	3,905.0	4,099.9	4,346.2	4,600.7	4,643.3	4,645.7	5,459.4	5,810.8	6,091.5	6,515.6	6,815.4	6,912.8	7,242.6	7,586.5
14 Chg@	6.1	5.0	6.0	5.9	0.9	0.1	17.5	6.4	4.8	7.0	4.6	1.4	4.8	4.7
15 Income Tax*	128.3	161.3	160.4	179.9	199.4	141.7	102.9	140.0	155.9	194.4	247.6	263.5	279.2	295.8
16 Chg@	11.3	25.8	-0.6	12.2	10.8	-28.9	-27.4	36.0	11.4	24.7	27.6	6.5	5.9	6.0
17 Gross Receipts Tax*	188.2	188.8	197.5	213.1	248.6	224.3	216.5	219.1	235.9	241.2	277.6	286.5	289.5	295.7
18 Chg@	7.0	0.3	4.6	7.9	16.6	-9.8	-3.5	1.2	7.6	2.2	15.1	3.2	1.1	2.1
19 Excise plus Franchise Taxes*	893.3	906.2	891.2	1,083.0	1,102.8	966.3	1,071.7	1,197.8	1,372.0	1,491.6	1,766.1	1,758.7	1,842.7	1,948.6
20 Chg@	9.2	1.4	-1.7	21.5	1.8	-12.4	10.9	11.8	14.5	8.7	18.4	-0.4	4.8	5.8
21 Gasoline Tax*	543.3	563.2	567.4	576.1	569.4	576.9	600.1	599.3	608.1	605.6	612.3	622.1	629.7	642.3
22 Chg@	1.4	3.7	0.8	1.5	-1.2	1.3	4.0	-0.1	1.5	-0.4	1.1	1.6	1.2	2.0
23 Vehicle Registration*	183.6	195.7	201.2	218.6	211.4	219.6	225.0	238.5	244.2	249.5	257.4	268.7	274.9	283.4
24 Chg@	-0.6	6.5	2.8	8.7	-3.3	3.9	2.5	6.0	2.4	2.2	3.1	3.6	3.1	3.1
25 Fuel Tax*	126.8	133.2	142.5	152.8	173.4	151.2	155.4	167.7	173.7	180.7	185.9	184.8	190.1	195.5
26 Chg@	0.2	5.0	7.0	7.2	13.5	-12.8	2.8	7.9	3.5	4.0	2.9	-0.6	2.9	2.8
27 Privilege Tax*	108.4	124.4	142.6	153.7	160.8	177.4	216.5	246.1	264.9	304.9	313.8	346.9	361.5	380.6
28 Chg@	8.6	14.7	14.7	7.8	4.6	10.3	22.1	13.6	7.7	15.1	2.9	10.6	12.9	5.3
29 All Other Taxes*	296.8	365.1	330.4	348.9	347.2	365.8	401.9	474.6	492.4	507.3	576.7	702.6	726.0	750.9
30 Chg@	0.6	23.0	-9.5	5.6	-0.5	5.4	9.9	18.1	3.7	3.0	13.7	21.8	3.3	4.2

* Millions of dollars
Annual economic data in lines 1, 3, 5, 7, and 9 are calculated in terms of fiscal years ending in HQ of the calendar year of the noted fiscal year
December 7, 2007

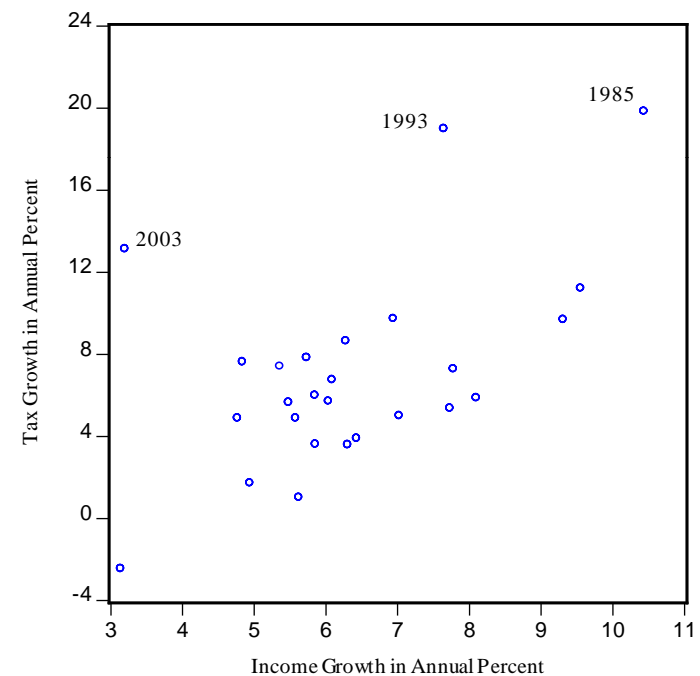
A Consistency Check

Top-down forecasting model projects growth in tax revenue based on personal income growth, controlling for tax rate changes in 1985, 1993, and 2003

Based on personal income projections, the consistency check is below

Growth is far stronger for FY 2007-08 largely because the model cannot capture the shortfall in the running rate for the franchise and excise taxes, the tobacco tax and to some extent the sales tax.

Growth for the coming fiscal year is in line with the baseline projection



	2006	2007	2008	2009	2010
Revenue Growth	6.8	7.4	4.7	4.0	3.9
Revenue (thousand of \$)	10,290,758	11,052,680	11,573,270	12,033,820	12,497,700



Contingency Views

Balancing the Risks

Probabilities

- Stronger growth 12.5%
- Baseline 50%
- Weaker growth 37.5%

Tilting the balance to weak-growth scenario: Asymmetric cost of forecast errors

- Lower than projected tax revenue is a bigger problem for the state than higher than projected tax revenue

Risk Scenario

Faltering U.S. growth with spillover effects to Tennessee

Personal income growth projections in is cut by 2.5% in 2008, 2.8% in 2009, and 1.4% in 2010 versus the baseline

Projected employment growth is cut by one-half a percentage point in 2008 and 2009 from the baseline

Results for this risk scenario, using the consistency model, are reported below

	2006	2007	2008	2009	2010
Revenue Growth	6.8	7.4	2.9	2.0	3.1
Revenue (millions of \$)	10,290,758	11,052,680	11,377,420	11,609,720	11,967,450



The U.S. Outlook – Problem Areas

Monitoring the Likelihood of Weaker Than Projected Growth

Winning the Peace

- Uncertainty for outcome in Iraq and Afghanistan remains
- Nuclear program in Iran remains unresolved
- Uncertainty over the security of nuclear weapons in Pakistan is a complicating factor

Global growth

- On the positive side, Pacific rim, including Japan, remains positive

Pricing power

- Ability to deal with inflation pressures and the fallout from the subprime turmoil may err on the side of accommodation

Sector problems

- Housing starts have fallen fast this year as mortgage credit has become more stringent
- Auto sales are beneath last year's pace, but fall has not been precipitous

Energy

- Oil in the \$90 range this winter will crimp discretionary spending
- OPEC pricing does not seem to be influenced by threshold price of tar sand and shale oil
- OPEC may have lost its ability to limit the upward spiral due to persistent strong oil demands

Interest Rate Cycle and the Yield Curve

- Yield curve shifted from downward to upward slope
 - Downward sloping yield curve has been harbinger of a recession
 - Positive slope may point to continued growth
- But information content of yield curve may be less reliable now compared with earlier interest-rate cycles
 - Hedge funds may have contributed to volatility
 - Shifts in foreign demand could affect long-term yields
 - Recent declines in short and intermediate yields could be driven by flight to quality

The Dollar in International Currency Markets

- Trade deficit remains wide, though exports are benefiting from weaker dollar
- Private foreign appetite for dollar instruments is weakening
- Capital inflow through official foreign institutions remain important but inflow may be siphoned by diversification of SWFs